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Legitimating Fiscal Stabilization: Ireland in Comparative Perspective

Niamh Hardiman.
UCD School of Politics & International Relations Niamh.Hardiman@ucd.ie

Patrick Murphy.
UCD School of Mathematical Sciences
Patrick.Murphy@ucd.ie

Orlaith Burke.
UCD School of Mathematical Sciences
Orlaith.Burke@ucd.ie

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Introduction

From the mid-1980s on, most of the developed economies experienced intensifying pressures to change their macroeconomic stance. The aftermath of the 1970s oil-price shocks had resulted in a pile-up of problems the most striking of which was a greatly increased public debt exposure, as governments had attempted to find alternatives to the dominant policy combinations of the postwar era (Glyn et al. 1992; Scharpf 1991). Inflation control and debt management emerged as higher priorities than the traditional objectives relating to full employment, with implications for both public spending and the distribution of taxation. While the combination of tax and spending priorities themselves continued to vary significantly across countries, the parallel trends toward financial market liberalization and cross-border capital mobility, combined with currency instability within the EMS, put pressure on governments to alter the way welfare state commitments were underwritten (Mosley 2000; Swank 1998). Hence the ubiquity of the perceived need to tackle fiscal stabilization during the 1980s.

By 1992, these commitments were encoded into the Maastricht convergence criteria for those countries intending to qualify for EMU by 1999. Debt reduction and restrictions on current account deficits were made a priority in order to strengthen 'good citizen' commitment to the common pool resources of currency stability and interest rate stability.

While cutting debt was perhaps more readily achieved across Europe in the buoyant conditions of the latter half of the 1980s, the recessionary conditions of the early 1990s (1992/3) required governments to engage in more active cost-cutting measures. After 1999, the terms of the Stability and Growth Pact were assumed to take over as generators of compliance with maintaining national government disciplines over the volume of debt and budgetary deficits, where interest rates and exchange rates were now centrally determined.

This paper explores some of the political dimensions of attempts to rebalance public finances, especially in the context of achieving EMU convergence criteria. Authoritative government decision-making, or the exercise of 'hierarchy', might be possible under specific domestic conditions, and the widespread move toward central bank independence also freed monetary policy decision-making from political veto from other social actors. But cutting spending or raising taxes, or some combination of both, is often politically very risky. More commonly, therefore, governments might either be required to, or find it more effective to secure consent from organized economic interests; and even without direct government involvement in legitimating disinflation, it has been argued that 'signalling' mechanisms from central banks work best if there is a coherent wage-setting structure in place that is capable of generating coordinated responses (Franzese and Hall 2000; Hall and Franzese 1998).

Social spending is likely to be particularly sensitive in areas such as pensions and other transfer payments, especially unemployment, disability and other benefits. Reforming these is likely to put particular pressure on governments. But one of the biggest single outlays governments have to deal with is public sector pay on core government functions, part of governments' non-social spending commitments (Castles 2007b). This makes public spending reform a very central issue for labour market policy as well as for welfare policy, and potentially a highly risky electoral issue.

The processes of fiscal stabilization took different forms though, and how the burdens of adjustment were to be distributed varied a good deal. The consequences of having an independent central bank and a particular exchange rate regime can be far-reaching (Hall 1986, chs. 9, 10). But over time, and within constraints, governments can strengthen or weaken particular institutional configurations that have a bearing on fiscal politics (Hallerberg 2001). Furthermore, research on the politics of fiscal policy has thrown up a number of interesting hypotheses to account for the trajectory and composition of change over time. Among these, much attention has been focused on party politics and especially the intra-governmental variations in power distribution. Hallerberg has produced compelling evidence concerning the impact of party system types and of single-party versus coalition government in parliamentary regimes on internal government decision-making, producing incentives to opt either for strong ministerial discretion, or for government policy pre-commitment to specific fiscal targets (Hallerberg 2004).

This paper suggests that the trajectory of fiscal adjustment may also vary according to the availability of interlocutor social interests and the potential for building negotiated agreements supporting new macroeconomic priorities. It has been suggested that the existence of 'corporatism' might be expected to drive up demands for public spending and therefore debt levels. Wagschal finds that such pressures were ‘no longer of any real importance’ by the 1980s (Wagschal 2007, pp.232-5). But an alternative proposal merits consideration, which is that the domestic coalitions in place during the 1980s and 1990s may have played a vital mediating role in shaping and possibly facilitating the adjustment process. The logic of ‘competitive corporatism’, for example – the new variant of corporatist exchange adopted by a number of countries in the post-‘Golden Age’ era, would not depend on increased public spending to secure agreements on pay restraint, but implies a ‘search for elaborate equity-based compromises and trade-offs’ with ‘new market-conforming policy mixes’ (Molina and Rhodes 2002; Rhodes 2001, pp.165-6; Traxler 2004). A number of analysts have already studied the origins of new forms of social pacts as a direct response to EMU, and have found that the pressures of dealing with debt and deficits can indeed explain changes in labour market institutions (Crouch 2000; Hancké and Rhodes 2005; Pérez 2002; Sbragia 2004) . Our concern is a little different, in that we seek to analyse how governments undertook processes of fiscal consolidation, from different starting point, in the context of particular constellations of actors and institutions – especially those affecting pay bargaining and labour markets. This paper is therefore exploratory in nature and does not yet claim to produce robust or systematic findings. The hypothesized relationships still need to be modelled and tested.

This paper has three sections. Firstly, we look at the overall profile of fiscal stabilization strategies. Secondly, we consider the patterns of adjustment depending on the context of political negotiation and legitimation within which it was achieved. Then we look more closely at the experience of Ireland, to consider in more detail some nuances in the political management of fiscal stabilization. In addition to illuminating a particular country experience, this case study provides some further suggestions about the interactions between players in a particular institutional context that will feed back into a more extensive pairwise set of comparative case studies, and in turn into the generalizing relationships we propose to firm up and test.

Comparative approaches to fiscal stabilization

We consider relative rates of change across three dimensions of fiscal stabilization here: debt levels; trends in spending; and profiles of tax revenues. From these, we seek to group countries according to the main profile of fiscal adaptation they undertook.

The dominance of debt

While most countries achieved cuts in debt levels, there is a great deal of variety in country profiles. In virtually all OECD countries we see debt increasing into the 1980s, but no uniform trend in falloff thereafter and indeed in some cases an increase in the scale of the phenomenon into the 1990s. As Figure 1 shows, Ireland was among a number of countries with a significant debt burden in the mid-1980s. Belgium Greece, Italy, experienced the most acute debt problems at the peak point, and notwithstanding the general trend toward debt reduction, continued to have the highest profiles into the 2000s.

Fig.1. Gross Government Debt % GDP

The scale of governments' debt interest payments captures another aspect of debt exposure insofar as it arises from not only the size of the debt, but also the way in which market assessment of risk bears upon domestic fiscal obligations, resulting in higher or lower interest burdens. Figure 2 shows that Greece, Italy, Belgium, Portugal, Ireland, Denmark were very exposed by the mid-1980s. The latter two show declining interest payment liability thereafter, while the former three experienced escalating exposure until the mid-1990s. Norway's oil and gas reserves put it in a very different situation from any other OECD country.

Fig.2. Gross Government Interest Payments as % GDP

Thus countries that had achieved 'low debt, low interest rate' status by 2005 include Ireland, Denmark, New Zealand, Australia, Finland, Netherlands, Canada, US, UK. Countries that still had persistently high debt levels in 2005 are Belgium, Greece, Italy (omitting those with debt levels closer to the 60% GDP threshold such as Sweden, Austria, Canada) (Wagschal 2007, p.226).

Trends in spending

As Castles has noted, there is no single secular trend across countries to cut public spending, whether in response to fiscal stabilization requirements or in response to globalization pressures (Castles 2007b). Overall though, we note that the 'ambitious reformers' who undertook spending cut strategies early on were Ireland, the Netherlands, Sweden, Finland, and New Zealand. Belgium and Spain attempted spending cuts, but later and with less success. Italy, Greece and Portugal were much more limited in the scale of their spending cuts (Hauptmeier et al. 2006).

But we note that there are patterns over time in aggregate trends, depending on the date at which spending cuts were initiated and how enthusiastic government seemed to be in progressing them. There are also variations in the relative emphasis on containing social versus non-social spending. As Castles has noted, there is relatively weak evidence of cuts to social spending over time, and cuts in core or non-social spending, plus debt interest repayments, are more often the case. The scale and incidence of spending cuts is highly dependent on the size of the original 'problem load', while countries starting out at low spending levels (such as Portugal) may have experienced some 'catch-up' spending tendency, especially in social spending. Figure 3 shows trends in total government consumption.

Fig.3. Government Consumption % GDP

Social spending, accounting for up to half of all public spending commitments, has attracted most research attending, as Castles has noted.

Fig. 4. Social Spending % GDP

Figure 4 reveals a general tendency for social spending to rise into the 1980s, with some curtailment thereafter, a dip in the late 1990s, but no wholesale aggregate retrenchment. Trade openness – in most countries – is associated with stronger upward pressure on spending in general, consistent with the argument about small open economies (Castles 2007b), although trends in Ireland appear to depart from this generalization over time (Hardiman et al. 2008). Highest peaks for Sweden, Finland, and Denmark, followed by a fallback, are particularly striking, but the trend does not continue systematically downward. A number of countries were engaged in restructuring their benefit entitlements in parallel with labour market activation policies over this period (Denmark, Netherlands, Sweden, also Germany; but more limited changes in Italy, France) (Dingeldey 2007; Vail 2008).

Among OECD countries, Ireland stands out in displaying quite significant fluctuations in social spending, from a high of 22% in 1986, to 13% in 1998 and 16% in 2006. As we shall see, the original 'problem load' included large-scale unemployment in the earlier period; so the significance of change in total spending needs to be assessed in a more disaggregated way. We also wish to return below to the issue of the GDP denominator in explaining Irish trends.

The biggest cuts in core spending were undertaken in Ireland and Belgium (Castles 2007a, p.25); these are areas in which government discretion is perhaps greatest.

Distributing the tax burden

Our evidence on tax adjustment is still in its early stages, but we note that profiles in taxation show some change over time. In particular, we note that in most countries total taxation as a proportion of GDP stays relatively steady, as Figure 5 shows. We note though a downward trend in Ireland after 1987.

Figure 5. Total Tax Revenue % GDP.

What is perhaps more interesting therefore is the profile of the distribution of the tax burden. Even though there is no evidence of any simple convergence in tax rates, it has been proposed that capital mobility, anxieties about tax competition, and competitiveness considerations, combine to constrain government discretion. Thus a shift in the composition of taxation can be expected away from capital taxation onto less mobile factors of production such as direct employee and social insurance charges. On the other hand, governments may seek to encourage the propensity to create jobs by reducing the tax wedge for business, that is, the sum of employee tax and social insurance plus employer social insurance and other payroll taxes. Revenue-neutral tax reform in Sweden, for example, took down personal income tax rates but maintained high consumption tax (Steinmo 2002). Where fiscal adjustment pay deals were struck, alleviation of employee tax burdens was often a quid pro quo of wage moderation (in Ireland and the Netherlands, for example).

Overall, research findings indicate that marginal rates of business taxation have come down. But base-broadening measures mean that, especially in conditions of economic buoyancy, the relative importance of capital taxation did not decline (Swank and Steinmo 2002). Much variation is still apparent across countries, depending on their internal political circumstances, including unemployment rates and trade openness (Adam and Kammas 2007). And both the level and progressivity of income tax still vary significantly across countries (Ganghof 2007). The institutional conditions under which tax policies are made are likely still to condition outcomes in the 'new political economy' of taxation under increasingly globalized conditions. Steinmo and Tolbert found that variations in party politics and parliamentary institutions continue to 'make a difference', and sought to assess how and under what conditions (Steinmo and Tolbert 1998). We propose that the strength and embeddedness of economic actors in the constellation of policy-making influences is likely still to be significant (Steinmo 1993).

What we can document so far is changes in the relative significance of different categories of taxation. Figure 6 shows the extent of variation over time in the significance of the taxation raised from corporate sources.

Fig. 6. Total Direct Business Taxes % GDP

In many countries, the marginal rate of tax on business has declined, as Fig. 7 shows. The drop in Ireland was particularly high, following from a rationalization of tax liabilities into a single rate in the early 1990s.

Fig.7. Changes in Corporate Tax Rates, 1993-2007.

Yet despite fluctuations, Fig. 6 shows no clear trend toward a declining reliance on business taxation. Indeed, in Ireland the trend in the salience of business tax as a proportion of GDP shows a steep upward trend – under conditions of very rapid growth, even lower tax rates yielded higher tax returns.

Meanwhile total direct taxes on households show interesting variations. Denmark and Sweden maintain higher rates than any other countries, but the biggest drops are in Sweden, Ireland, and the Netherlands, as Fig. 8 shows.

Fig. 8. Total Direct Taxes on Households as % GDP

The tax burden on the 'average production worker', taking the single earner here as indicative, also shows interesting variation, both over time and across countries, as Fig. 9 shows. The rate of income tax on the (single) Average Production Worker rises until the mid-1980s but thereafter shows a decline in Sweden, Denmark and Finland – which still keep high rates – also in the Netherlands. But by far the most striking downward trend in the average rate of income tax is seen in Ireland, from a peak of 30% to 11% in 2006. This was a larger drop than even the Danish one from 44% to 30%, keeping a heavy reliance on income tax including on employees (Ganghof 2005). Moving in the opposite direction are France and Belgium, with Switzerland and Austria showing almost no change.

Fig.9. Personal income tax as % gross wage earnings, single APW

What may be of some interest therefore is to consider the degree to which countries may depend on taxing business as opposed to taxing employee income.

There may be many background determinants of these preferences, including economic structure and industrial composition, and reliance on FDI, among others. But it is important contextual information for understanding the political forces operating on decisions about change in tax burdens, and specifically in deciding how the burden of fiscal stabilization is to be distributed.

Figure 10 shows the overall ratio of household to business taxation. (Spikes for Britain and Finland are thought to arise from accounting lags). What is apparent here is quite a widespread relative decline in reliance on taxation of household income, relative to taxes on business.

Fig. 10. Ratio of household to business taxation – all

In order to assess the trend more clearly, we simplify the graph somewhat, looking at fewer countries: this is Figure 11.

Figure 11. Ratio of household to business taxation – selection

What stands out here is the relative extent of reliance on household incomes as a source of revenue during the 1980s, at the peak of the crisis of both unemployment and fiscal pressure. We note an especially high ratio in Ireland, bearing out the observation that direct employee income was bearing a disproportionate share of adjustment to fiscal crisis during the 1980s – and its very sharp decline thereafter.

Composite trends

Overall, we identify some clustering in patterns of fiscal adjustment that are broadly consistent with the clusters we might identify from literature on the politics of tax and spending – but with some interesting puzzles and anomalies. As a heuristic guide, we draw on Esping-Andersen's worlds of welfare capitalism (Esping-Andersen 1999) and on typologies of industrial relations systems (Ebbinghaus 1998).

Christian Democratic

The Netherlands and Belgium were both within the D-Mark zone during the 1980s, pegging their currencies to the deflationary bias induced by the Bundesbank. Nevertheless, there is a marked contrast in the fiscal stabilization trends apparent in both countries. We suggest that a significant element of the explanation may be the contrast in the capacity of the state to engage potential veto players in consent to a viable strategy. In the Netherlands, an early employer-labour initiative in 1982 set the groundwork for a negotiated capacity to adjust to new pressures. But the fragmentation of the Belgian state was compounded by the disaggregation of the labour market actors, and governments were obliged to attempt fiscal stabilization unilaterally – but less successfully (Hemerijck et al. 2000a; Hemerijck et al. 2000b; Jones 1999).

Scandinavian/Social Democratic

Finland cut spending very sharply and managed a bigger debt problem than other Scandinavian states, as a result of the particular difficulties in which it found itself during the 1980s and into the 1990s (high reliance on wood products, collapse of the USSR). Sweden and Denmark were also 'virtuous reformers', if this is what fiscal stabilization implies. Finland had not previously had organized structures of wage determination, whereas both Sweden and Denmark had shifted from centrally negotiated pay bargaining to more decentralized patterns. But these also had embedded in them a more routinized adherence to macroeconomic priorities (Traxler 2000). How Finland overcame the potential for veto player blockage is perhaps the most interesting question here.

Liberal/market

Ireland and Britain feature as 'ambitious reformers'. New Zealand's electoral system change in the 1990s slowed its earlier capacity for unilateral government initiative, which puts it in the 'timid reformer' camp (Hauptmeier et al. 2006). But in Britain and New Zealand, government did not face strongly organized trade unions and therefore had a freer hand in determining macroeconomic priorities. Ireland is an outlier in this cluster, because strong and well organized unions and a sectorally differentiated industrial structure could have placed it in the same camp as Belgium. Instead, a new approach to coordination and a political process that put debt reduction centre-stage facilitated perhaps the most striking process of fiscal stabilization of the cases surveyed here.

What seems apparent here is the under-determination of fiscal stabilization pathways, and the scope for contingent political adjustment strategies.

Political management of macroeconomic stabilization

We suggest that the political negotiation of consent to debt reduction and constraint on public spending has a significant bearing both on the scale of the fiscal changes undertaken and on the distributive impact of how change is brought about. Where social pacts could be negotiated successfully at the outset of the fiscal stabilization process, governments could move faster and more successfully to rebalance public finances and generate conditions more favourable to sustaining growth, such as in Ireland and the Netherlands. In Portugal, too, EMU stimulated the formation of a debt-beating social coalition 1987-1997, resulting in some very wide-ranging agreements on pay and macroeconomic management. There are implications also for the impact of spending cuts and change to the distribution of the tax burden – but as we have noted, the packages do not necessarily hang consistently together, and much clearly depends on the scope of bargaining agreements, the extent of the role of organized interests in influencing labour market policy and the trade-offs between employment and social protection (or employment security attached to the employment relationship as opposed to security within the labour market overall) (Anderson and Pontusson 2007; Scharpf 1998).

Alternatively, where social pacts were not actually initiated in the 1980s but had a longer or more established existence, fiscal stabilization priorities could be implemented more easily where the industrial relations system had already internalized the priority of spending reduction. The original problem was less significant and the perceived need for adjustment less urgent. This is clearly the case in Germany. But without a capacity to engage in priority-changing negotiation at the national level, the risk was that entrenched interests would continue to provide veto power over welfare spending and labour market policy – all issues that were addressed through social pact type negotiations. Also relevant here is the spread of the hard-currency regime within the EMS to neighbouring countries which internalized the Bundesbank's priorities over time, including the Netherlands, Belgium, and Austria; but also France in the wake of the disastrous early Mitterrand policy of fiscal reflation and its subsequent adherence to the 'franc fort' line (Busch 1993; Hancké and Rhodes 2005; Schmidt 2002; Soskice 2000) .

Where labour market institutions were based on decentralized bargaining with little coordination and/or little capacity to internalize macroeconomic priorities, governments might nevertheless be able to undertake unilateral cuts in spending, and changes to the tax system, that had major implications for employees, but which they were unable to influence significantly. We might expect in these circumstances that the adjustment strategy would shift tax burdens onto fixed sources (employee incomes, consumption taxes) rather than onto business interests (corporation tax, payroll-increasing social insurance). We wish to explore this in relation to Britain and New Zealand.

But where unions were nevertheless strong yet disunited, unilateral government implementation of its declared priorities was likely to prove very difficult. This was the case Belgium and in Greece; also in Italy and Portugal at different stages, because their pacts proved difficult to sustain over the longer term. In Italy, ‘technocratic’ governments in 1992, 1995, sought to work out agreements with unions and employers in conditions of crisis and with explicit EMU context (Culpepper 2008; Molina and Rhodes 2007). Where pacts had been initiated but did not endure (Italy), we suggest that the fact that the labour market institutions were unable to sustain agreement made it harder for governments to adopt coherent policies of fiscal stabilization. Italy and Portugal initiated social pacts in this period (Italy 1992, 1995; Portugal 1987-1997) – they had no other means of containing inflationary pressures such as the DM peg. Both countries adopted pacts that included wide-ranging remodelling of social security arrangements and labour market protection systems. They underwent a condensed phase of institutional reform to fit them for EMU. The social pacts provided the legitimation for achieving fiscal stabilization. Spain engaged in policy-by-policy negotiations within framework agreements, again under pressure of EMU, to avoid government-imposed industrial relations (Hancké and Rhodes 2005; Pérez 2000).

In the period after the implementation of EMU, a number of authors have suggested that the continuation of social pacts may have a different significance (Hancké and Rhodes 2005; Traxler 2004). The origin of pacts can be explained by a widely accepted need to adjust to what were agreed to be dominant priorities of debt reduction and improving competitiveness. If the original ‘problem load’ was successfully internalized and institutionalized, this will have taken the emphasis off pact-making as the dominant strategy for dealing with the issues. Thus if issues about labour market cost management, welfare state reform, training etc., were to be dealt with successfully, they would have to move into other areas of policy processes and cease to be the constant focus of open bargaining.

Ireland stands out among the countries in which fiscal stabilization leaned heavily on social negotiations: very little in the industrial relations system or economic structure would have predicted such an outcome (Hardiman 2002b). Social partnership proved to be central to macroeconomic adjustment strategy. However, the continuation of national-level pay agreements has seemed to outside observers to be a symptom of the weak embeddedness of these priorities within the bargaining system. Where social pacts continued to be focused on national level headline pay agreements, it may be a sign that pay bargaining continues to be conflictual, superficially managed, subject to regular contestation (Traxler 2004). But it has also been noted that the very continuation of this way of managing economic performance permitted the range of bargaining issues to be broadened considerably, to take in a whole variety of labour market issues (Hardiman 2006).

Nevertheless, we do not expect to see fiscal stabilization depending so much on social pacts in the period after 1999: labour market institutions came to function differently and the external constraints of the Maastricht criteria ceased to be overtly present (Hassel 2006).

Negotiated fiscal adjustment: the Irish case

In this section we briefly profile the extent of the fiscal turnaround in Ireland and the main strategies for dealing with it. We consider the role of social partnership agreements in facilitating this, and institutional supports to strengthen their impact; we but also point to some difficulties in interpreting their significance, and limitations to their impact.

As Hallerberg et al have noted, budgetary management in Ireland does not fall readily into either of the models seen elsewhere, based either on the delegation of powers to the finance minister, or on a fiscal contract that is binding on coalition partners (Hallerberg et al. 2007). This means that Irish fiscal policy has been subject to party political contention and to somewhat greater volatility over time than if there had been formal budget-setting rules or institutions in place. Certainly the discretionary role of Finance Ministers (particularly the Fianna Fáil ministers Ray MacSharry between 1987 and 1989, and Charlie McCreevy in the late 1990s and early 2000s) has been noted (Hardiman 2002a). Some aspects of public spending produce cross-party consensus: for example, the commitment to low rates of corporate income tax was maintained consistently by all governments from the 1950s on, changing only in gaining clarity and prominence as a principal instrument of industrial policy (Hardiman 2005). Some aspects of decision-making on tax and spending policies appear to be highly subject to the lobbying of special interests and organized representation by vested interests, or by the possibility that a less than open exchange of favours takes place through the under-regulated system of political party funding (Hardiman 2004).

However, we wish to suggest that social partnership did facilitate an institutionalized agreement over many aspects of priority-setting that lasted from 1987 at least until the end of the 1990s. We suggest also that other institutional innovations over this time helped to strengthen issues of debt reduction and fiscal balancing to a greater degree than previously. Management of the public debt was put on a longer-term footing in 1990 with the establishment of the National Treasury Management Agency (NTMA) as the asset and liability management branch of the Irish government. From 2001 it also took over management of the newly created National Pensions Reserve Fund (NPRF) to secure budgetary provision for social welfare and public service pension liabilities from 2025 on. Moreover, under the terms of the Public Service Management Act 1998, government departments were enabled to undertake multi-annual budgeting on a formal basis, which was intended to reduce the pervasive short-termism of departmental scrambling to maximize budget allocations on an annual basis.

Profiling fiscal performance: debt, inflation, unemployment

The scale of the fiscal crisis experienced by Ireland during the 1980s is clear from the OECD comparative graphs. Figure 12 also shows the scale of the debt burden expressed in terms of GNP, which presented enormous problems of stabilization. This was all the more serious because although comparative data are normally reported in terms of GDP, the salience of inward FDI (Foreign Direct Investment) in Ireland meant a growing divergence between GDP and GNP, and scholars frequently report both figures to provide a more accurate representation of actual domestic fiscal politics, as Fig.13 shows. Figure 14 shows the inflation and unemployment problems, which together created a serious political bind during the 1980s – especially under conditions in which, as noted earlier, the tax system already bore particularly heavily on employees.

Figure 12. Debt as % GNP – Ireland

Figure 13. GNP and GDP – Ireland

Figure 14. Inflation and Unemployment – Ireland

Inflation began to decline in the mid-1980s. But well before Ireland committed to the Maastricht convergence criteria in 1992, inflation control at a much lower level had been established, which is attributable to the social partnership process begun in 1987. Inflation began to rise again in the early 2000s – as we have anticipated, the disciplines of EMU were not sufficient to constrain governments and social partners to adopt new disciplines under conditions of fixed exchange rates and no control over domestic interest rates. Meanwhile unemployment stayed stubbornly high until after 1994 during a spell of 'jobless growth', but started to fall sharply with the increased FDI investments the fuelled the 'Celtic Tiger' boom (Barry 2004).

Growth

The key therefore to understanding fiscal stabilization during the 1990s in Ireland is the turnaround from acute problems of stagnation during the 1980s to rapid growth during the 1990s, as Fig. 15 indicates. Even though, as noted above, GDP overstates the extent of the rise in living standards possible within the domestic economy, it is still strikingly at odds with trends elsewhere, especially from 1994 on.

Fig. 15. GDP Growth

In the context of rapid growth and a steadily rising tax intake, budgetary policy turned around radically from the deficit-ridden 1990s, and from 1988 until 2000 governments ran a primary balance, as shown in Fig. 16. Changes in government's budgetary stance at that time, combined with the international economic down of 2001, changed matters; overall, we consider that it forms part of a model of economic management within EMU that merits further discussion in a later section.

Fig. 16. Government Primary Balance % GDP

Social partnership pay agreements and cost management – wage restraint, tax reform

The first of what became a series of centrally negotiated national framework pay agreements arose from a process of domestic political reflection on extreme crisis in the mid-1980s. Decentralized but highly conflictual wage setting from 1981, even under conditions of very high unemployment, was still associated with high strike levels and persistently high inflation. A profound reorientation of trade union priorities was taking place, and the tripartite National Economic and Social Council

(NESC) initiated a process whereby agreement on the key problem facing the economy could be worked out. In a key strategy document in 1986, the issues of addressing debt through public spending cuts versus increased taxation were reframed as problems of changing the debt-to-GNP ratio, turning a zero-sum confrontation into the possibility of a positive-sum game (Culpepper 2008; Hardiman 1988; Hastings et al. 2007; NESC 1986). This laid the foundation for a conditional pay agreement the following year, brokered by the incoming minority Fianna Fáil government and supported from outside government by the next largest party, Fine Gael. The pay deal was explicitly framed to support a combination of sharp spending cuts, relief of employee taxation, and wage restraint. But the package nevertheless delivered increases in real disposable incomes, facilitated by the improvement in the international economic environment (MacSharry and White 2000).

New social partnership agreements were subsequently negotiated at approximately three-year intervals, and continue to date. They proved capable of being adapted to deal with unexpected adversity, such as the interest rate crisis of 1992/3. Acceptance of the Maastricht targets was built into the framework agreements of the 1990s. And despite some sectoral tensions, they withstood conditions of full employment in the late 1990s, and continued into the post-EMU period (Hardiman 2000; O'Donnell and O'Reardon 2002; Roche 2003).

Central to the pay agreements was government commitment to offset wage restraint by reform of employee taxation (Hardiman 2002a; 2004). As noted above in the comparative tables and also below in Fig.17, the incidence of taxation on employees declined steadily.

Fig. 17. Average Tax and Social Insurance on Employees – Ireland

The relevance of social partnership to wage restraint has been disputed. Some economists have taken the view that social partnership merely masked the effects of market disciplines and that the labour market in Ireland was essentially self-regulating. Insofar as growth did *not* result in a wages explosion during the 1990s, they argue, this is largely attributable to plentiful labour supply from women, returning skilled migrants, and newly qualified young people, as well as from the pool of unemployed. Wage competition provides a sufficient explanation for the fact that wage growth trailed profits growth. Social partnership, in this view, may at most play a role in legitimating the outcomes that markets are producing anyway (FitzGerald

1999; Walsh 1999). The wage-tax deals in the social partnership agreements, in this view, can be seen as forming part of an overall and overdue strategy of tax reform; tax cuts feature mainly as an electoral programme of successive governments rather than as core elements of a quid-pro-quo in pay policy.

This interpretation is unduly reductionist, based as it is on equilibrium labour market models, and omits consideration of the dynamic effects of the institutional changes in the Irish labour market arising from social partnership-based wage-setting (Baccaro and Simoni 2002). But rather than thinking of social partnership as a vehicle for enforcing wage restraint – at which it had a somewhat patchy performance, in the context of fragmented representative structures and sharp sectoral differentiation of the economy – it is perhaps more useful to regard it as a mechanism for facilitating a change in the pay-tax relationship that also held inflation in check, and facilitated large-scale employment creation, at least into the 2000s.

Spending profile

A profile of Irish government current spending as a proportion of either GDP or GNP shows a remarkable trend. Current spending rises steadily during the 1960s and 1970s, and indeed social spending started to grow late relative to other European countries and displays a tendency to engage in catch-up. A sudden spike in the late 1970s reflects the attempt by an internally conflicted Fianna Fáil government to spend its way out of recession, compounding problems of pro-cyclicality in the ensuing international downturn and laying the foundations of the fiscal crisis of the 1980s (FitzGerald 2000; Honohan 1992; 1999; Ó Gráda 1997). Spending climbed steeply until the mid-1980s. The coalition government of Fine Gael and the Labour Party (1983-7) was equally constrained electorally from raising taxes and cutting spending, in conditions of mass unemployment and enormous debt. While some controls were introduced to current spending, such as a freeze on public sector recruitment, it was not until the latter part of the 1980s that spending began to come down from what was widely regarded as an unsustainable level.

What is perhaps surprising is the continuing downward trend in government current spending during the 1990s (with a brief rise in the early 1990s, a time of increasing unemployment and current crisis), despite the very impressive growth of these years, as shown in Fig. 18 below. It is this trend that has led commentators such as O’Connell and Ó Riain to suggest that Ireland was engaging in welfare state retrenchment over this whole period (Ó Riain and O'Connell 2000).

Fig. 18. Government current spending % GDP and GNP – Ireland

The story is a little more complicated though, and become clearer when we look at two further pieces of information: actual aggregate spending trends on one hand, and a breakdown of the composition of spending on the other.

Fig. 19 shows the actual trend in government current spending, translating the three currencies in use since 1960 (parity with sterling until 1979, IR£ within the EMS until 2001, € thereafter) into a common standard which is a constant 1990 price.

Fig. 19. Government Current Spending in Constant 1990 Prices – Ireland

This graph demonstrates that the Coalition governments of 1981-2 and 1983-7 had begun to constrain spending, and that spending did in fact fall in real terms in the late 1980s. It shows too that there was a strong upward trend in government current spending during the boom years, which would not suggest a priori any evidence of ongoing welfare state retrenchment. What was indeed the case was that GNP and especially GDP growth was so intense in the second half of the 1990s that spending did not keep pace with it. Strongly stimulatory budgets (under Fianna Fáil Finance Minister Charlie McCreevy) between 1999 and 2001 sharply reversed the pattern of running a fiscal surplus and provoked criticism from the ECB for breach of the Stability and Growth Pact.

Social spending relative to GDP shows a marked rise during the 1980s and a cutback subsequently. Compared with the total aggregate trend of government current spending relative to either GDP or GDP, we do not see any secular downward trend. Remembering how rapidly GDP was growing in the mid to late 1990s, it is perhaps the relatively flatness of the trend in social spending that is most remarkable here, as Fig. 4 above showed. In this graph we see that Irish social spending comes in at the very bottom of the OECD countries surveyed. Is it the case perhaps that social spending was not curtailed, as it was for example in the Nordic countries, because it was so low there was neither need nor indeed perhaps even scope for reducing it to facilitate market-conforming adjustments? But why then do we not see the growth that might otherwise have been anticipated, especially in a small highly open economy?

It has been suggested that the aggregate data on social spending in Ireland may be somewhat misleading though. With relatively low rates of age dependency, the draw on pensions payments (even if set at relatively low levels – only reaching 30% of the gross average industrial wage in 2006) is lower than in other countries. Very low unemployment further reduced the need for social spending. There is a case to be made that adjusting for these considerations brings Ireland's level of social spending closer to the OECD average (de Buitléir and McArdle 2003; O'Connor 2003).

The issue of the divergence between what might have been anticipated about investments in income maintenance and social services under conditions of relatively prosperity, and the actual trends in evidence, need to be examined further. We need to look more closely at the composition of government spending, especially current spending. For the present, what we show in Fig. 20 is the breakdown of total government spending by policy sector.

Fig. 20. Sectoral Allocation of Government Total Spending, 1960-1995

What this demonstrates is that debt repayment had reached extraordinarily high proportions by the mid-1980s, but even after the reorientation of the public finances, supported by social partnership deals, after 1987, debt financing continued to absorb significant volumes of spending. What is also apparent from this graph is that both social security spending and health care suffered real cuts in the late 1980s. This was the consequence of the sharp phase of retrenchment. Indeed, this was in fact contrary to the election pledges made by Fianna Fáil prior to the 1987 election, when they undertook not to cut programmes that would hurt working class and welfare-dependent voters – a promise that gave them their largest ever share of lower-income votes (Coakley and Gallagher 2005). Within social security spending, a number of changes took place in the nature of entitlements over time, especially in the early 1990s, to remove the unemployment and poverty traps that created disincentives to move from welfare dependency, especially long-term unemployment supports, into employment (McCashin 2004).

Fig. 21 shows the breakdown of public spending for the period 1995-2005 (there was a break in the official statistics series).

Fig. 21. Irish Government Spending by Policy Domain, 1995-2005

From this we see that debt servicing fell off as a component of total spending. But social spending continued to rise, notwithstanding a dip around 2000, at a time of virtually full employment; so did spending on health. There is clearly a disparity between the evidence of an increasing rate of spending in these areas and public perception of poor quality in service delivery, especially in health care. While part of the explanation must be sought with reference to remedying historical deficits, the issues that arise focus mainly on value for money, organizational efficiency, and effectiveness of service delivery (Tussing and Wren 2006; Wren 2003).

Emergent challenges under EMU

The challenges of managing the public finances after January 1999, when exchange rates of participating countries were locked into the Euro, have changed somewhat. Greater adaptive pressures are thrown onto domestic cost adjustment strategies, once interest rate management and exchange rate setting are removed from national control. This implies that not only fiscal policy but also national wage determination systems acquire a new salience. But the paradox is that consequences of maladjustment may not be apparent to actors until after market disciplines have provided a painful reminder. Monetary policy disciplines are further removed from national actors and are likely to be very much less credible as a discipline in small states. Therefore loss of competitiveness may result in unemployment and market-led feedback, before the implications are fully absorbed within national deliberative processes (Franzese and Hall 2000).

The negotiation of social partnership agreements in Ireland during the 2000s proved more difficult than previously: pay deals were struck for shorter durations, reflecting uncertainty over the sustainability of the deals in a context of more volatile inflation, fuelled by a growing government reliance on indirect taxation (as reflected in Fig.22) and significant increases in government current spending, as much as by rising fuel and other exogenous sources.

Fig. 22. Indirect Taxation as % GDP

This fed rapidly into rising labour costs: it was no longer at all apparent that social partnership was functioning as a wage restraining mechanism. The exercises in using expert bodies to benchmark public sector pay against private sector comparators proved contentious. Economists complained that it was not transparent and was over-generous to the public sector (O'Leary 2002); yet it seemed likely to intensify sectoral grievances instead of depoliticizing public sector pay as intended.

The government current account balance slipped into deficit during 2000 and despite some recovery in 2004, went on a downward negative trend. New problems of competitiveness began to loom larger, and with declining FDI, reduced rates of exports, and a slowdown in construction, much slower growth was inevitable and unemployment seemed likely to rise (National Competitiveness Council 2007).

The process of consensus-building about the problems facing the economy and the parameters within which pay deals could be struck had served Ireland well from 1987 for a number of years thereafter. It had proved capable of shifting to accommodate new challenges. It remained uncertain whether the model of wage bargaining, and its role within the overall management of the public finances, had run its course, or whether it could once again be revitalized to re-negotiated a new approach to adjustment (O'Donnell and O'Reardon 2002).

Conclusion

One of the most striking features of Ireland’s fiscal stabilization from the peak debt years of the mid-1980s to the mid-2000s was the remarkable combination of trends: the debt to GDP ratio declined dramatically; public spending as a proportion of GDP (or GNP) also declined; and tax revenues also declined. On the face of it, the Irish state was shrinking steadily, disappearing from view.

The oddities of these trends are readily explained by the astonishing levels of growth Ireland experienced from 1994 on, especially in the late 1990s, and slowing somewhat thereafter, with signs of significant slowdown only becoming apparent in 2007/8. It is tempting to think that Irish governments had relatively few hard choices to make once the hard initial work of fiscal stabilization had been secured by the early 1990s – they were able to rely on steady growth to reduce sharp trade-offs and ensure positive-sum outcomes.

Despite the truth of this observation, we suggest that social partnership was nevertheless vital as a mechanism for facilitating the trade-offs and ensuring that the experience of growth did not dissipate in inflationary industrial conflict. Social partnership provided a mechanism through which tax reform could be undertaken and especially the systematic reduction of the tax wedge on employees reduced to facilitate employment creation. Moreover, the extension of social partnership into a whole range of issues impinging on labour market performance, including social welfare rates and income maintenance of all sorts, meant that the issues of social solidarity were at least kept under review throughout this period. While income inequality in Ireland is relatively high in comparative OECD terms, much of this is explicable in terms of the profound changes in labour force composition, the marked uprating of the quality of much employment, and the rising educational attainments of successive cohorts of labour market entrants (McGuinness et al. 2008; Nolan and Maitre 2007). However, it is also true that issues about management of the public finances are never fully contained within a stable framework of decision-making, and remain open to either discretionary political priority-setting, or the insider influence of powerful groups.

These reflections on the trends emerging from our analysis of the Irish experience suggest that a number of our explanatory themes may have been at work in other countries too, especially European countries exposed to the disciplining experience of preparing for Euro membership. While a range of factors have been investigated to help explain patterns of fiscal stabilization, we suggest that the role of social partnership mechanisms and 'social dialogue' more broadly – most often studied in relation to labour market adjustment strategy – merit further analysis.

Fig. 1. Gross Government Debt as % GDP

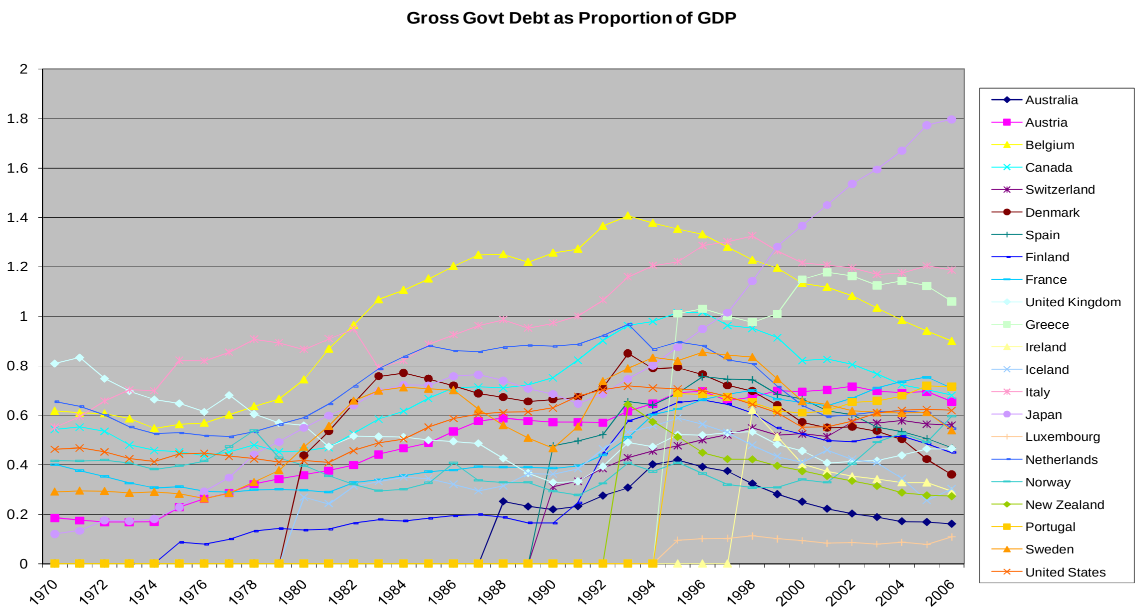


Fig. 2. Gross Government Interest Payments % GDP

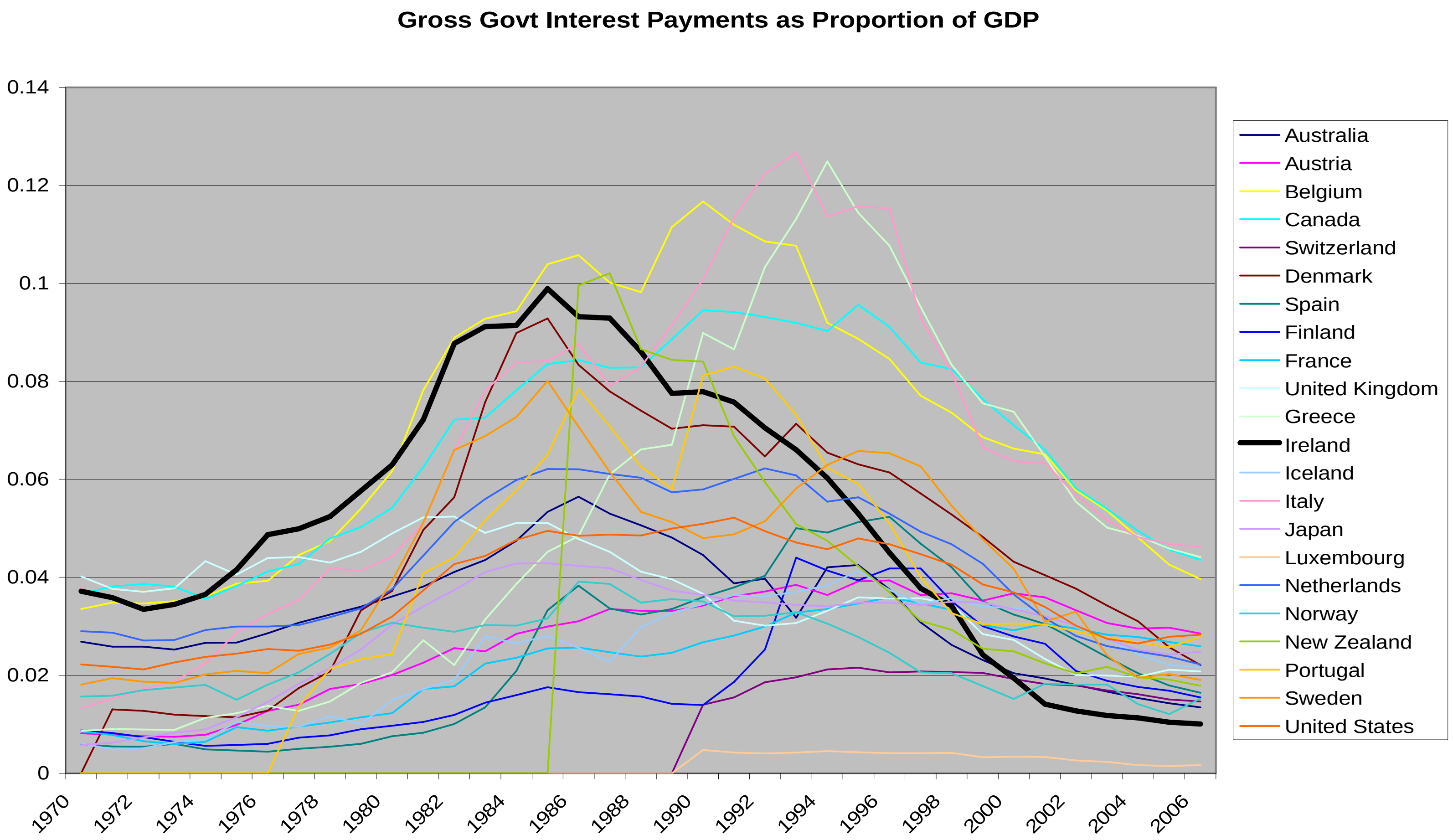


Fig. 3. Government Consumption as % GDP

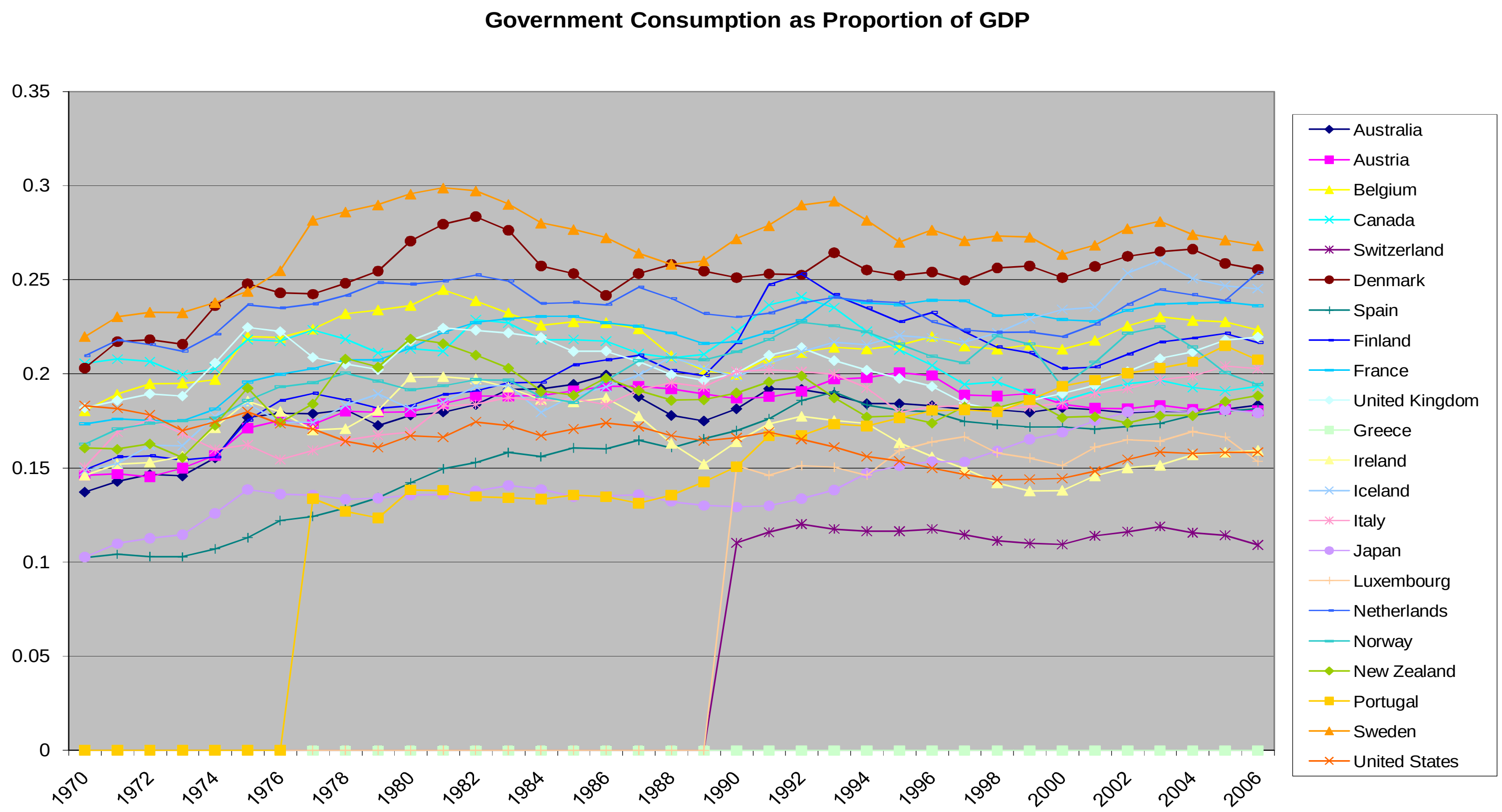


Fig. 4. Total Social Expenditure % GDP

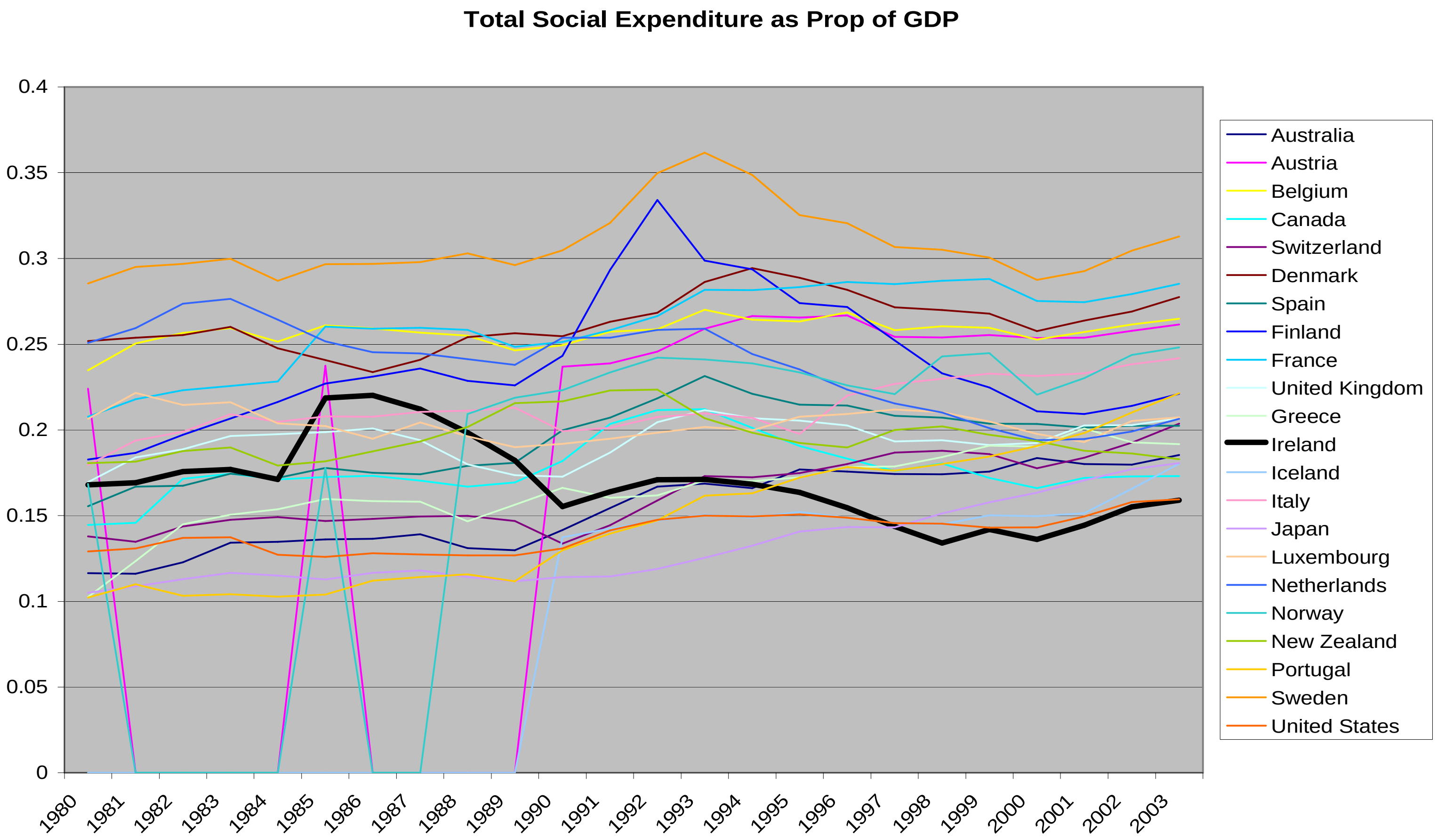


Fig. 5. Total Tax Revenue as % GDP

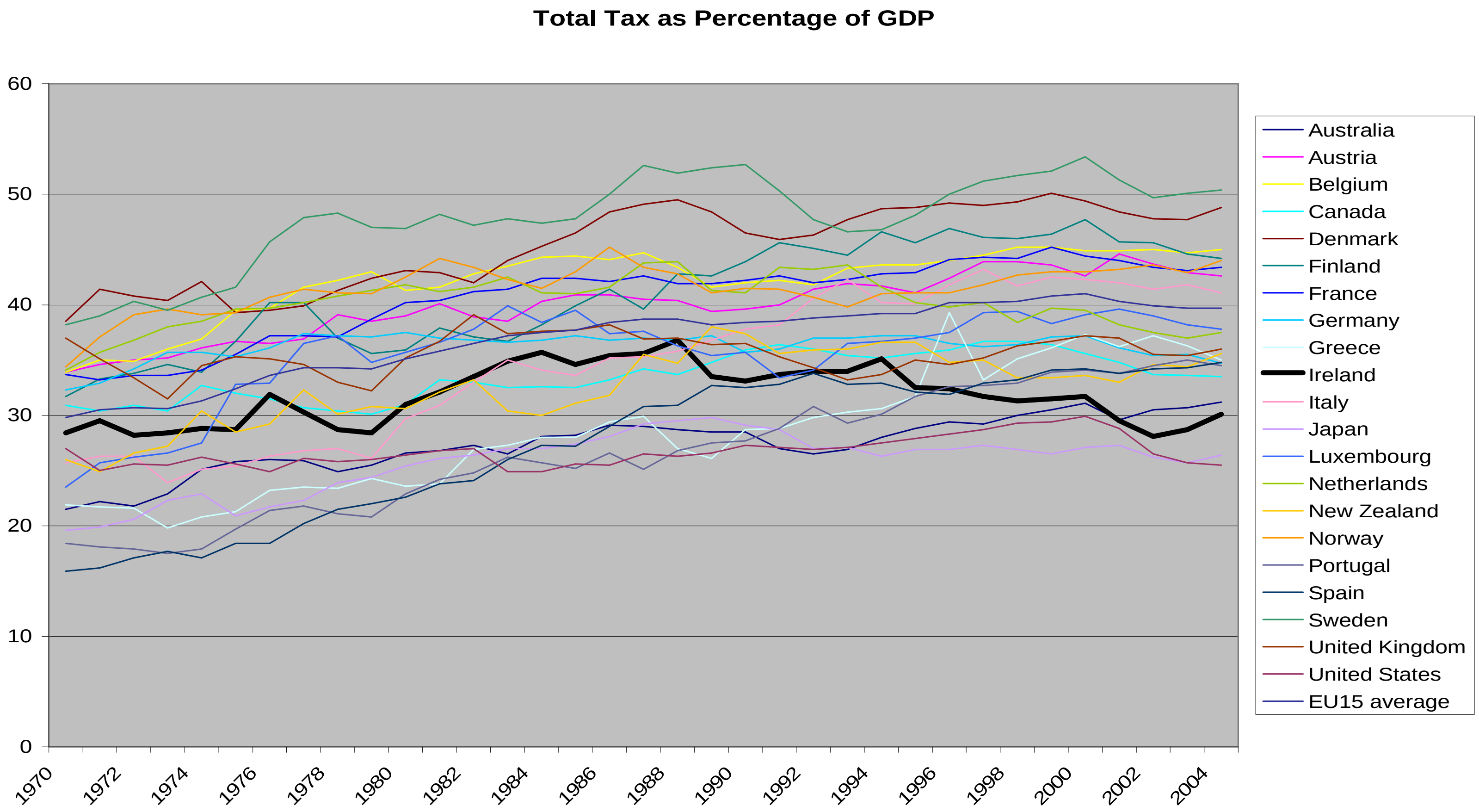


Fig. 6. Total Direct Business Tax % GDP

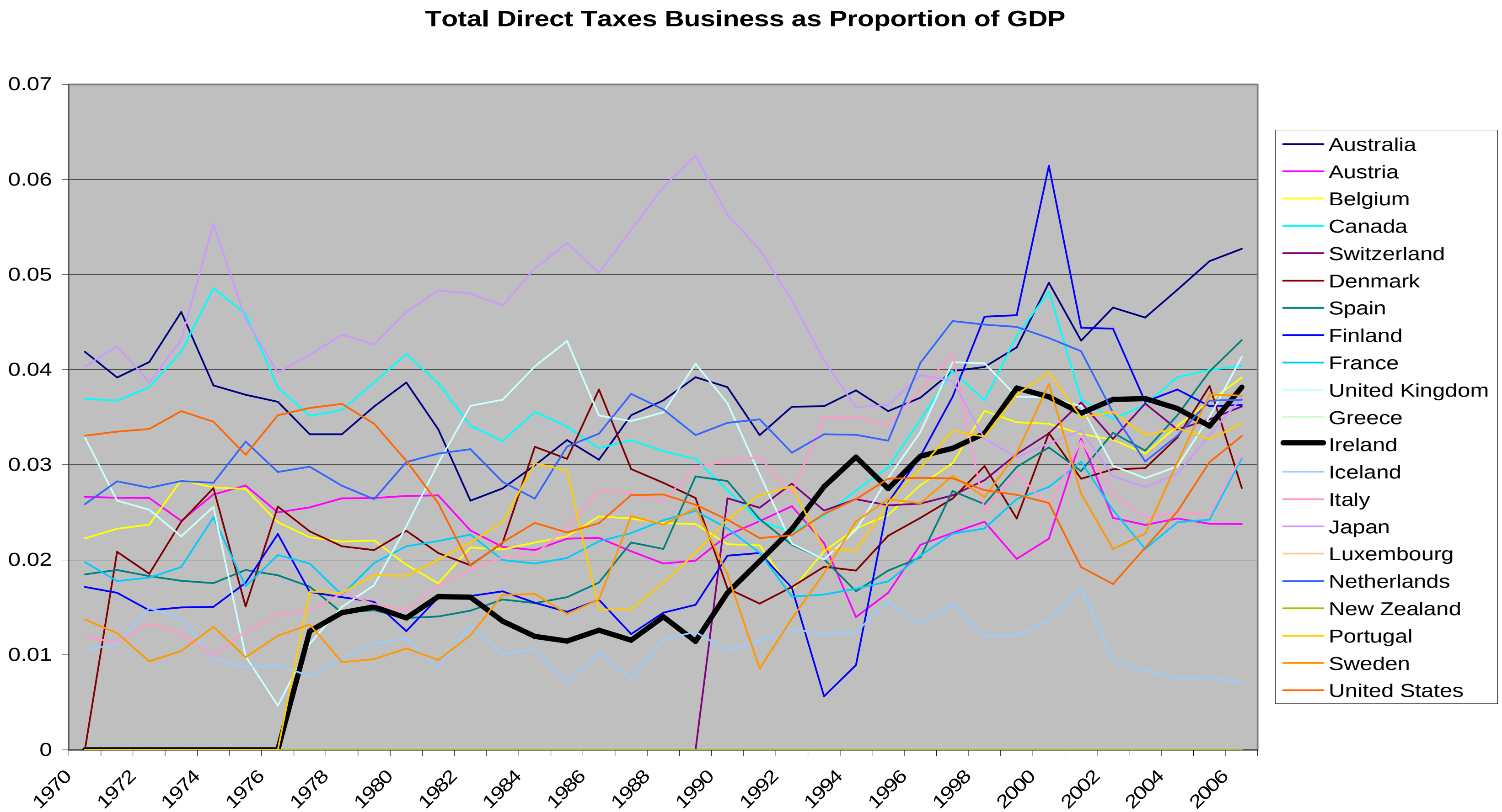


Figure 7. Corporation Tax Rates, 1993-2007.

Country	1993	2007	Change
Australia	33	30	-3
Austria	39	25	-14
Belgium	40	34	-6
Canada	44	36	-8
Denmark	34	28	-6
Finland	25	26	+1
France	33	33	-
Germany	60	38	-22
Greece	35	25	-10
Ireland	40	12.5	-27.5
Italy	52	37	-15
Japan	52	41	-9
Luxembourg	40	30	-10
Netherlands	35	26	-9
New Zealand	33	33	-
Norway	28	28	-
Portugal	40	25	-15
Spain	35	33	-2
Sweden	30	28	-2
Switzerland	29	21	-8
United Kingdom	33	30	-3
United States	40	40	-

Source: KPMG's Corporate and Indirect Tax Survey 2007. http://www.kpmg.com/NR/rdonlyres/A180267A-7423-40C6-87C5-7D917585541F/0/2007CorporateandIndirectTaxRateSurvey.pdf

Fig. 8. Total Direct Taxes on Households as % GDP

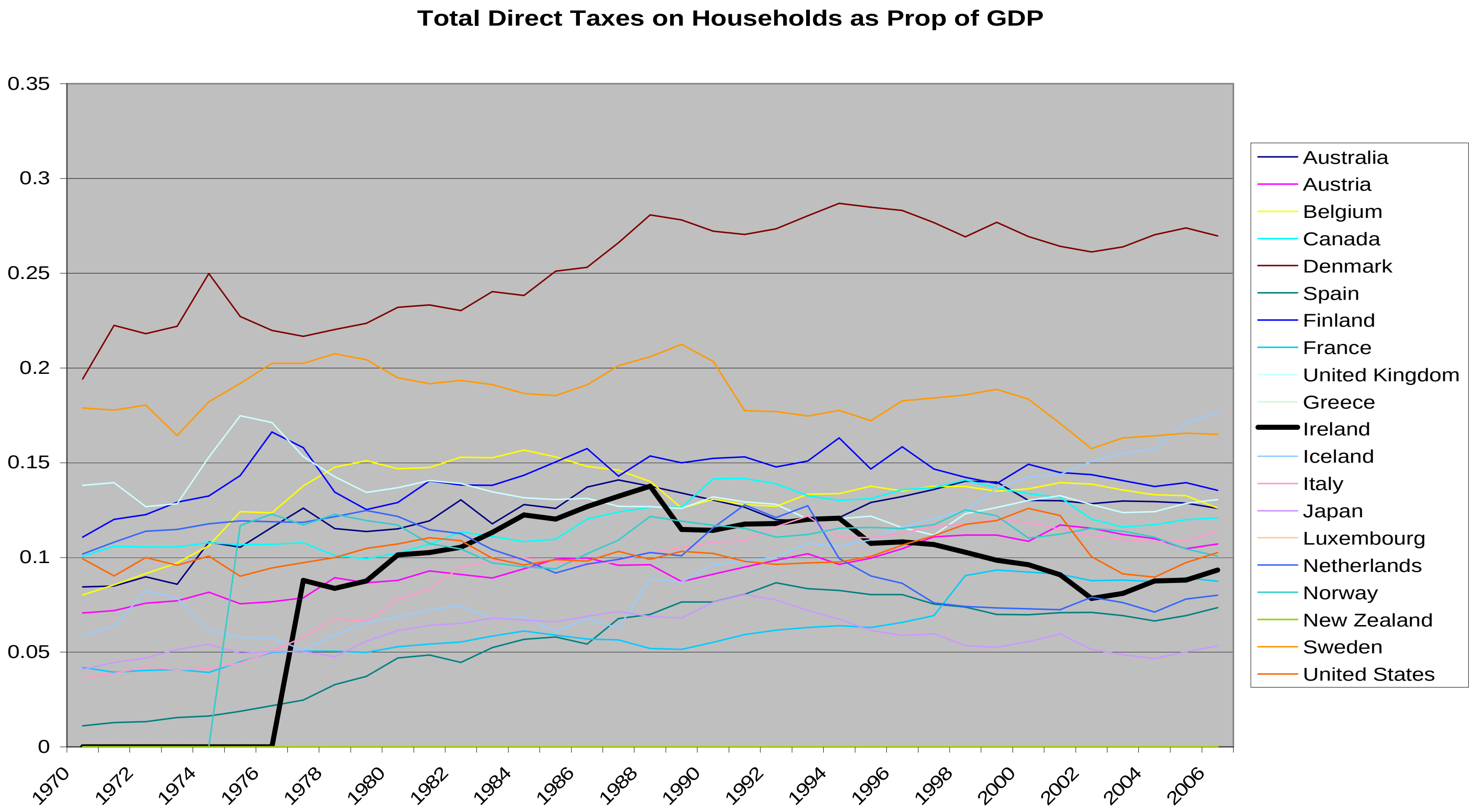


Fig. 9. Personal income tax as percentage of gross wage earnings, single APW

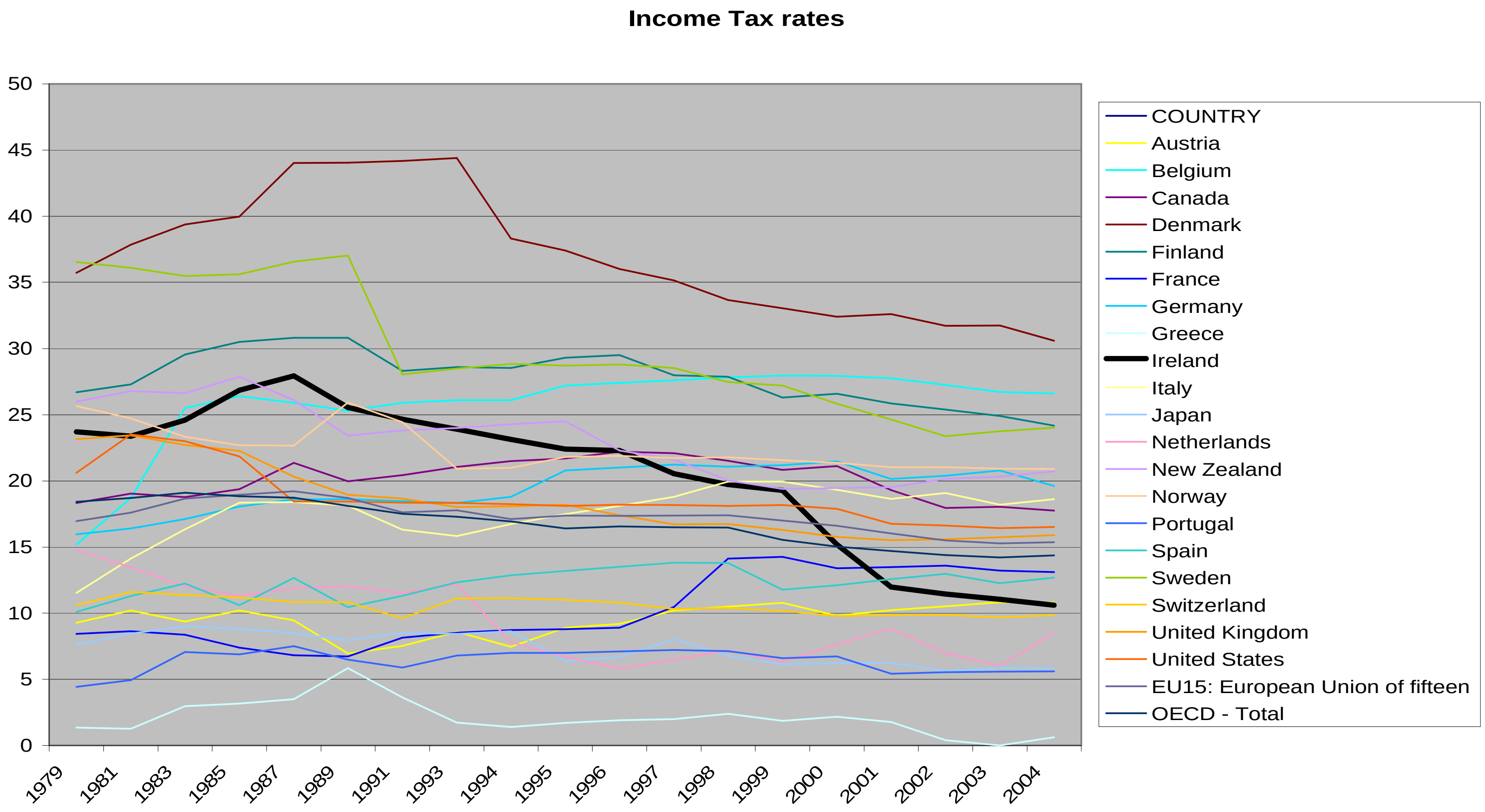


Fig. 10. Ratio of household to business taxation – all

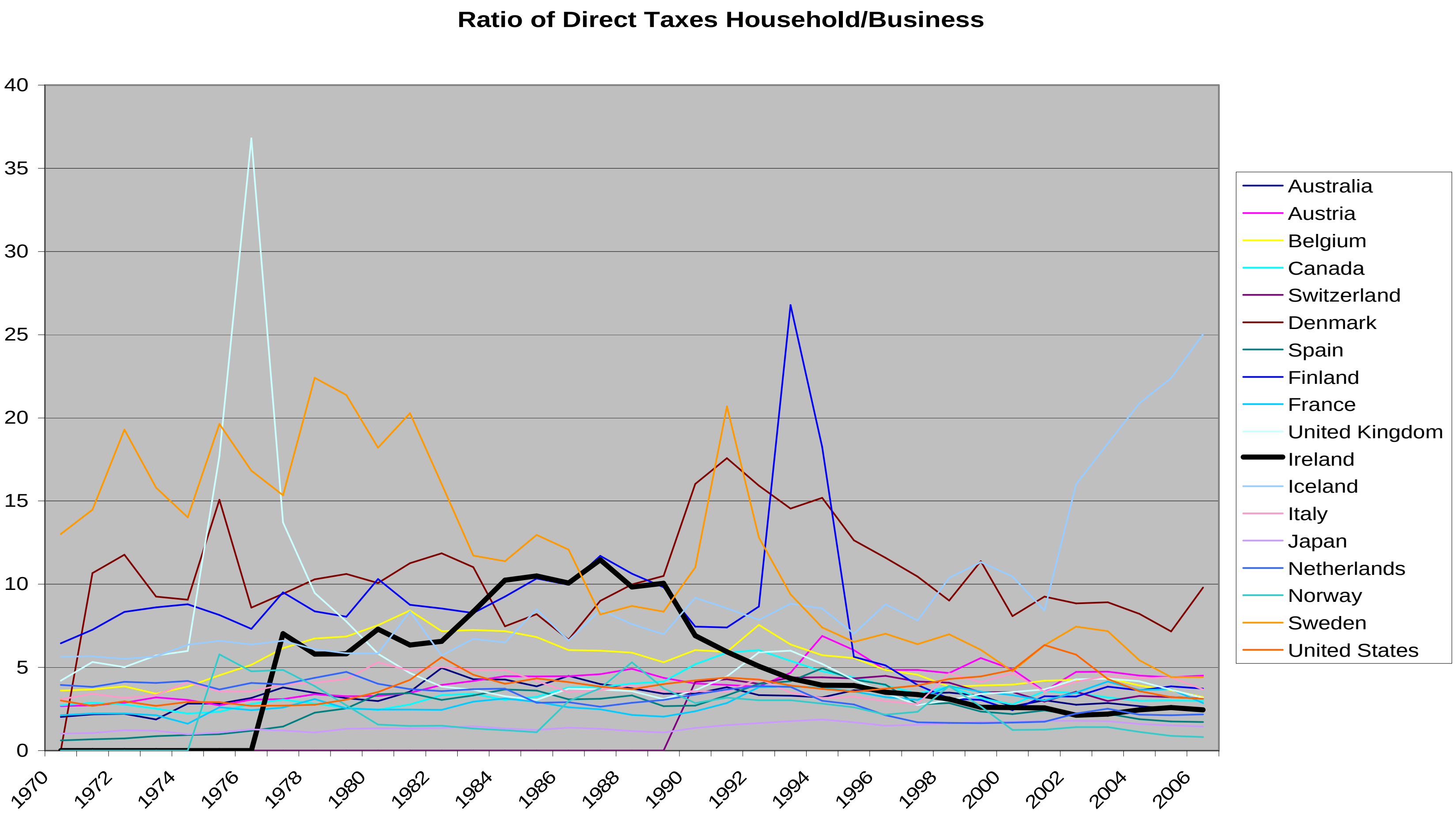


Fig. 11. Ratio of household to business taxation – selection

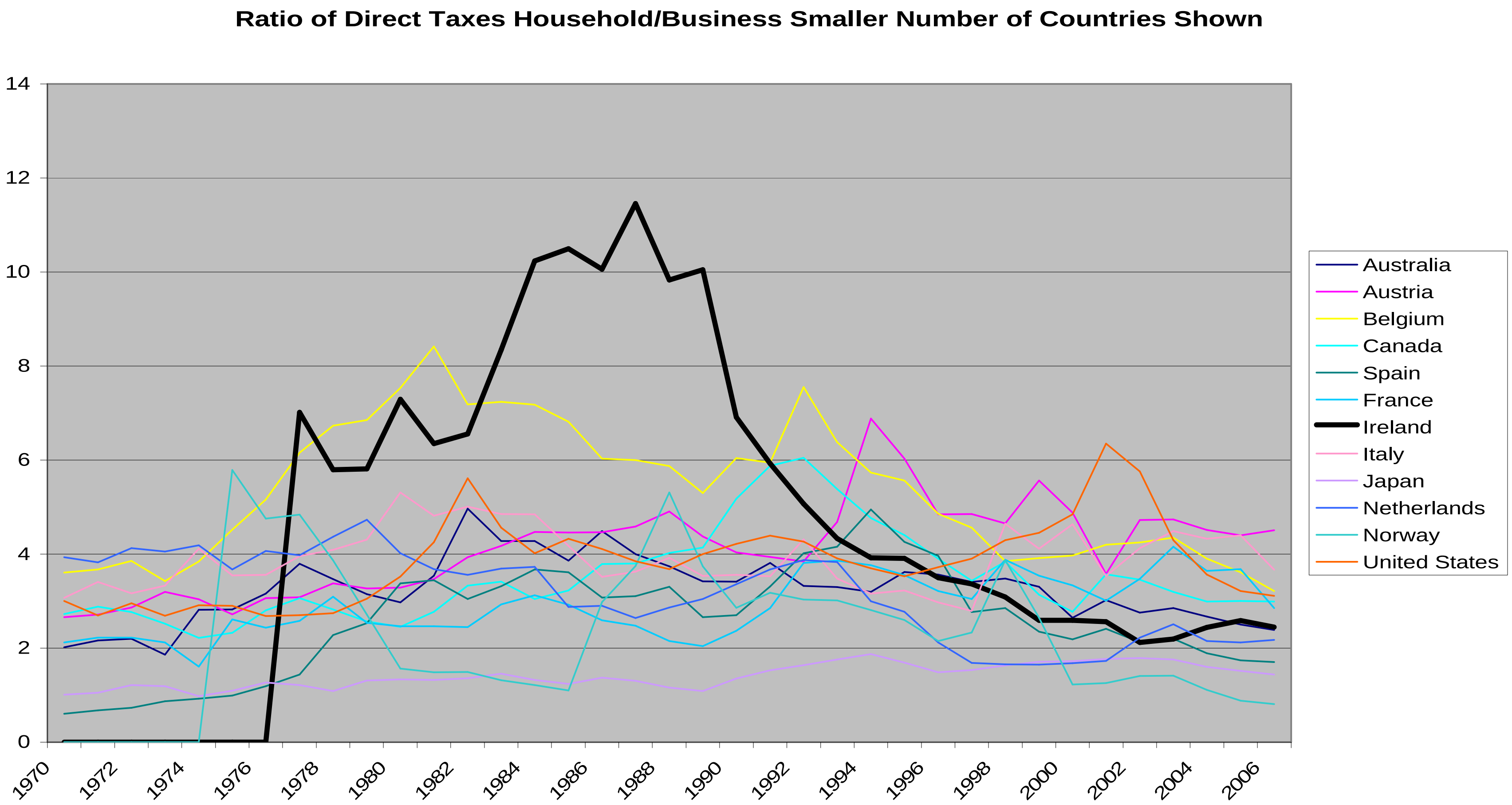
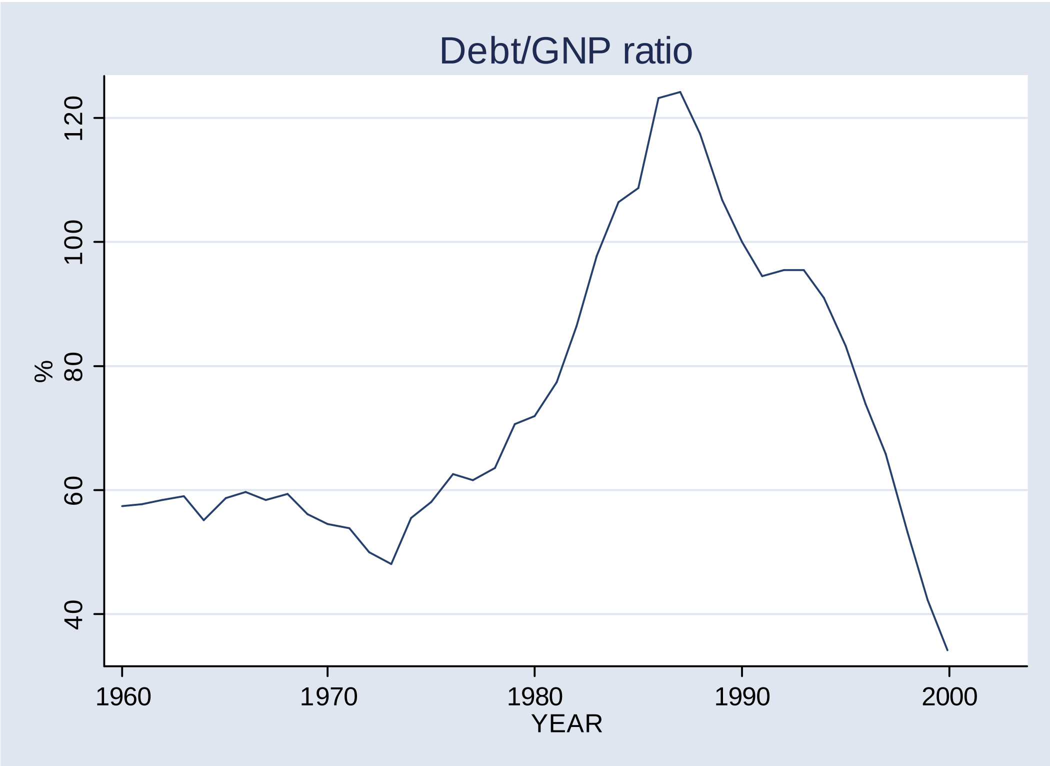
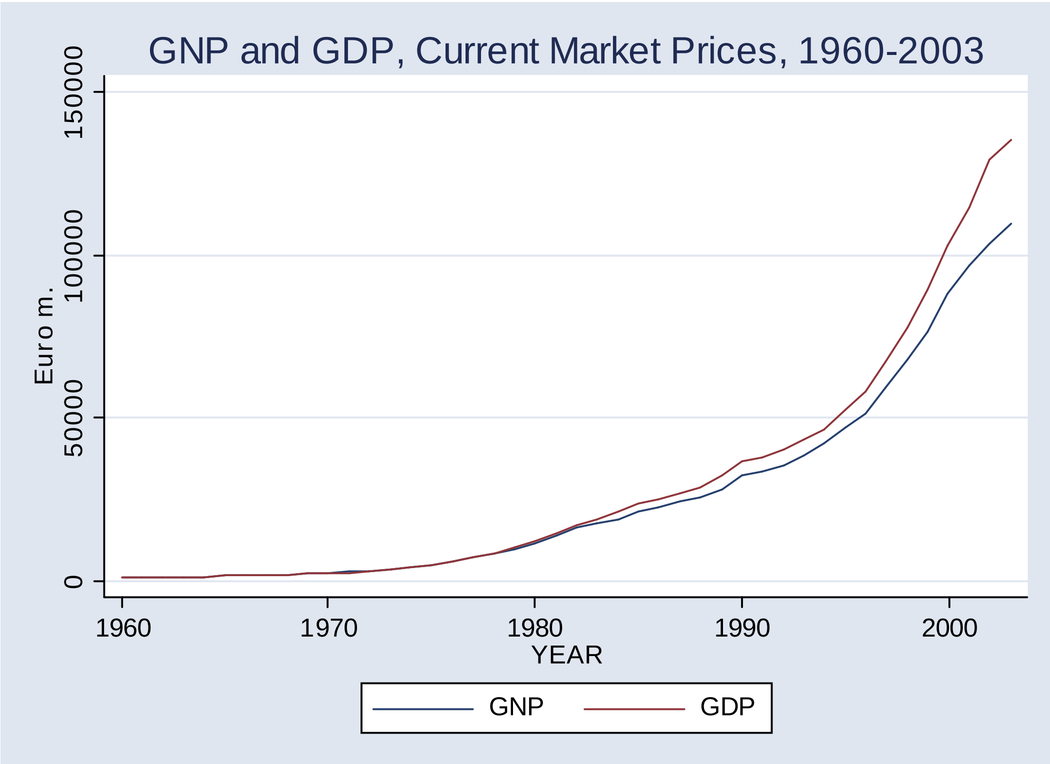


Figure 12. Debt in Ireland as % GNP



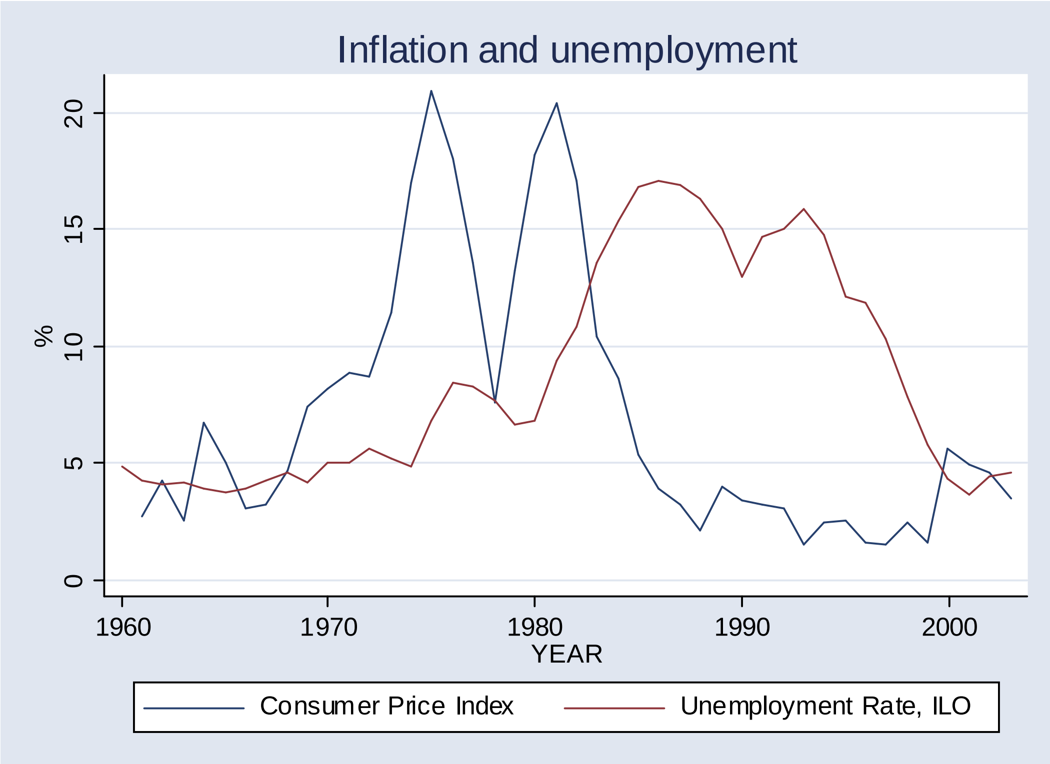
Source: ESRI Databank

Figure 13. GNP and GDP – Ireland



Source: Irish Central Statistics Office, http://www.cso.ie and Economic and Social Research Institute (ESRI) Databank, http://www.esri.ie

Figure 14. Inflation and Unemployment – Ireland



Source: Department of Finance *Budgetary and Economic Statistics*, 2004.

http://www.finance.gov.ie/documents/publications/other/bes_04.pdf

Fig. 15. GDP Growth – OECD

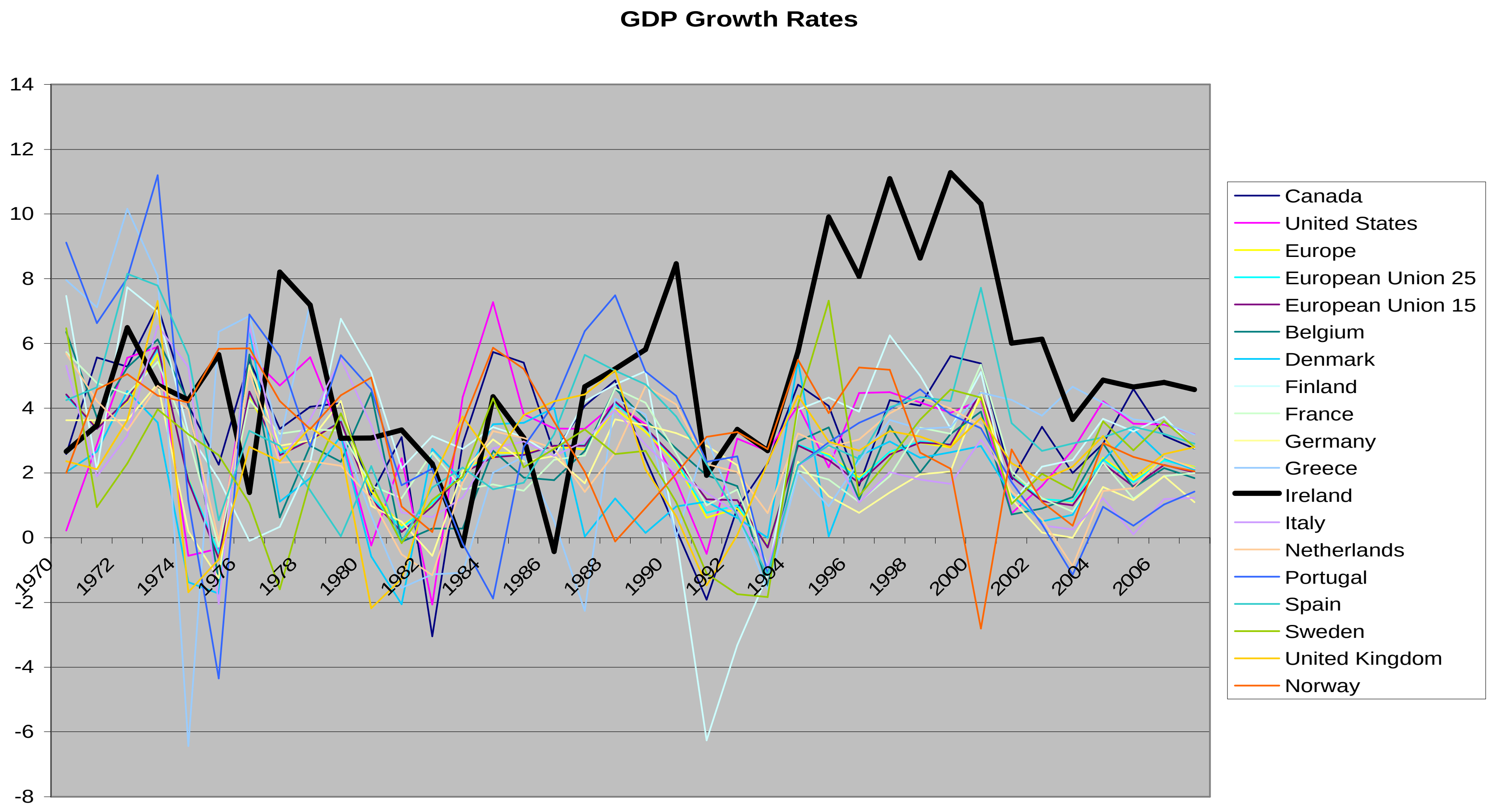


Fig. 16. Government Primary Balance – OECD

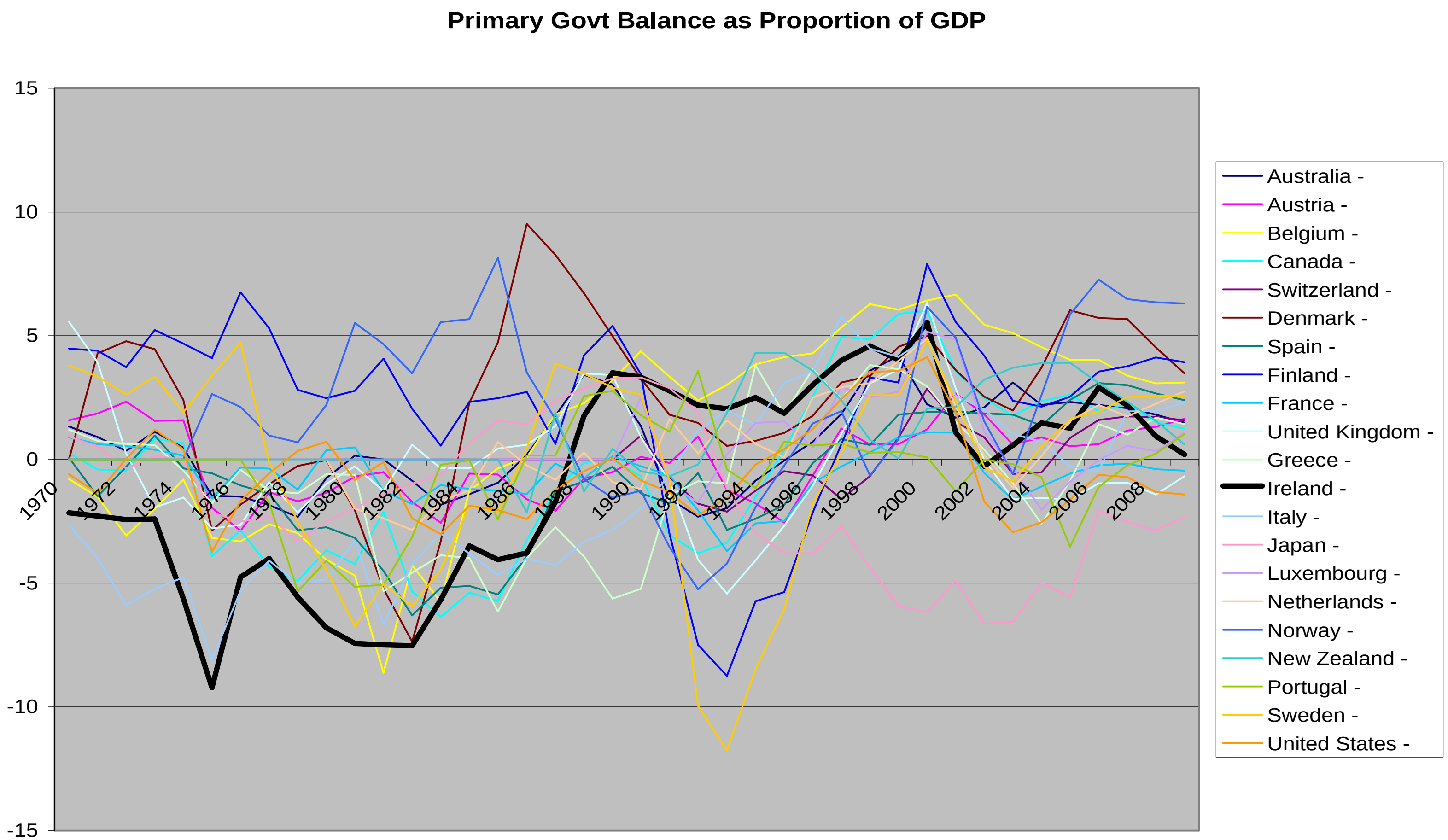
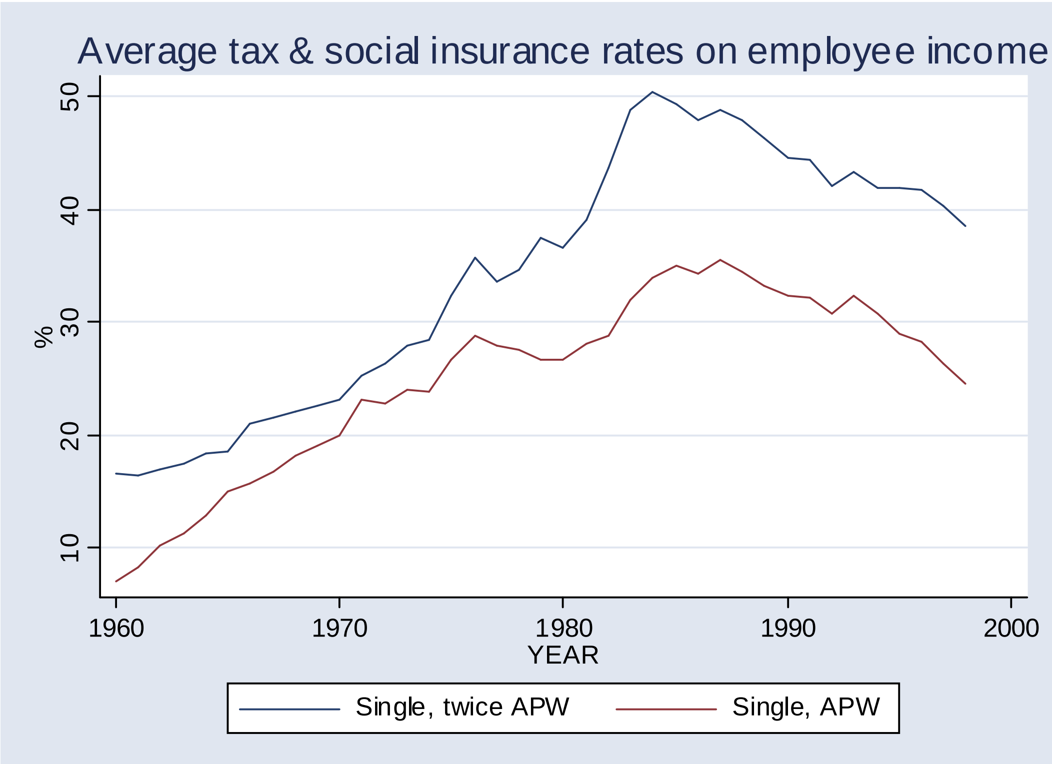
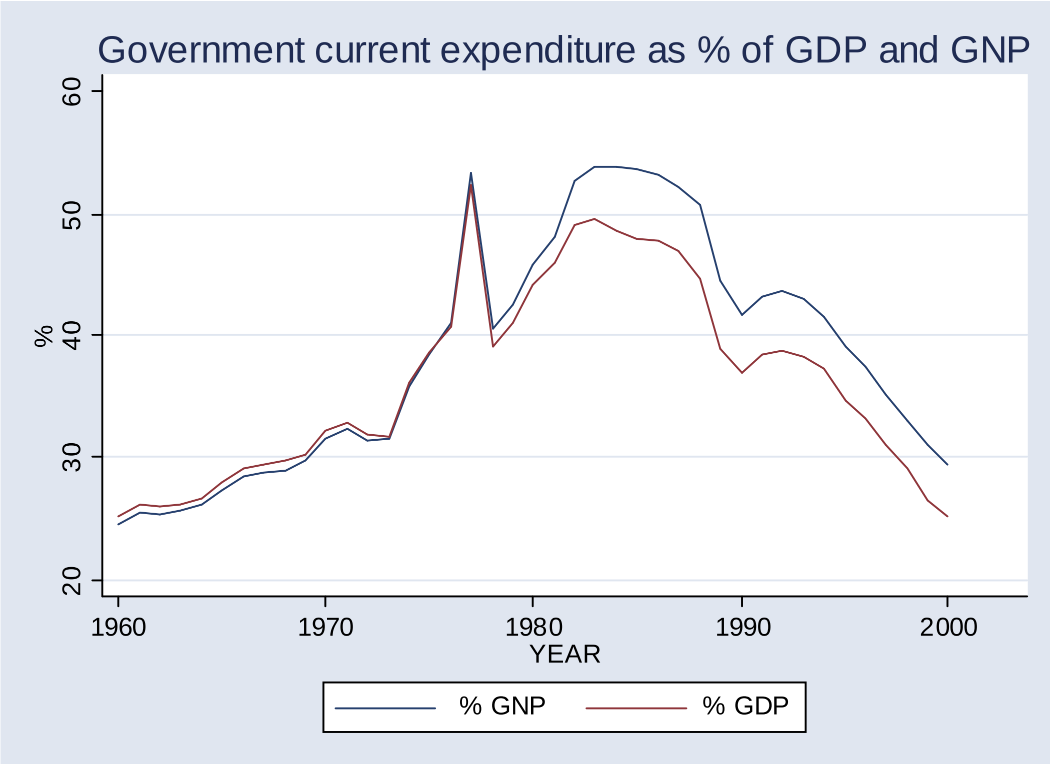


Fig. 17. Average Tax and Social Insurance on Employees – Ireland



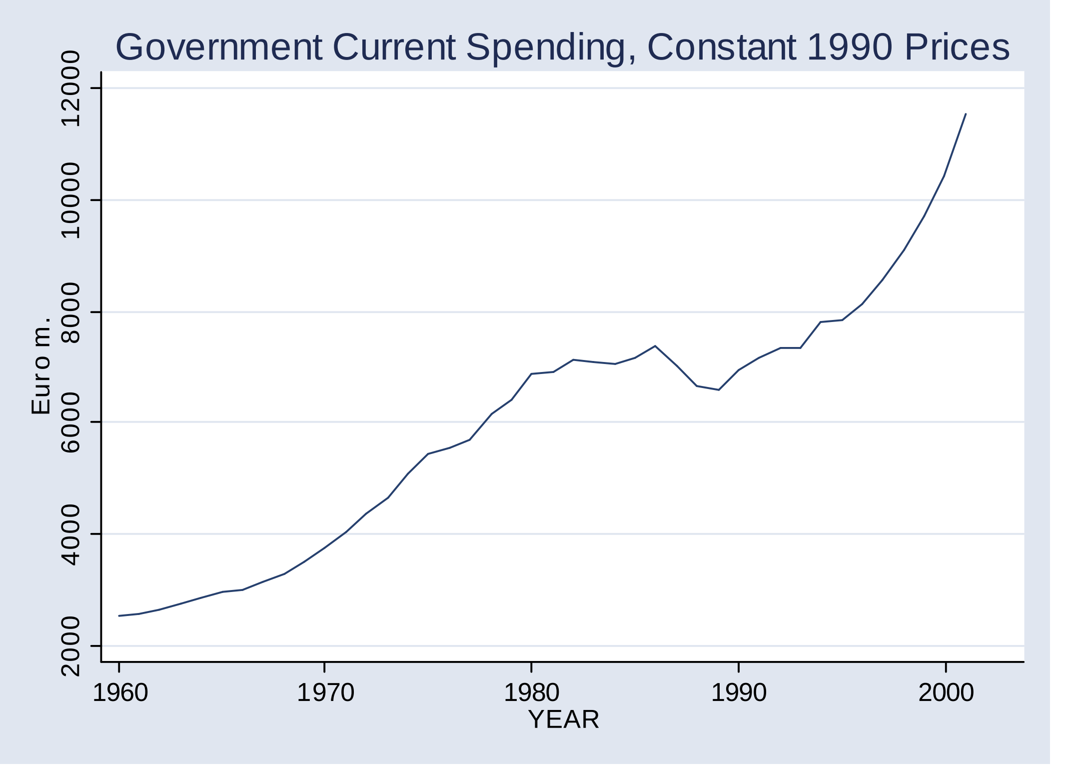
Source: Calculated from Central Statistics Office and Revenue Commissioners' data (Hardiman 2002a)

Fig. 18. Government current spending % GDP and GNP – Ireland



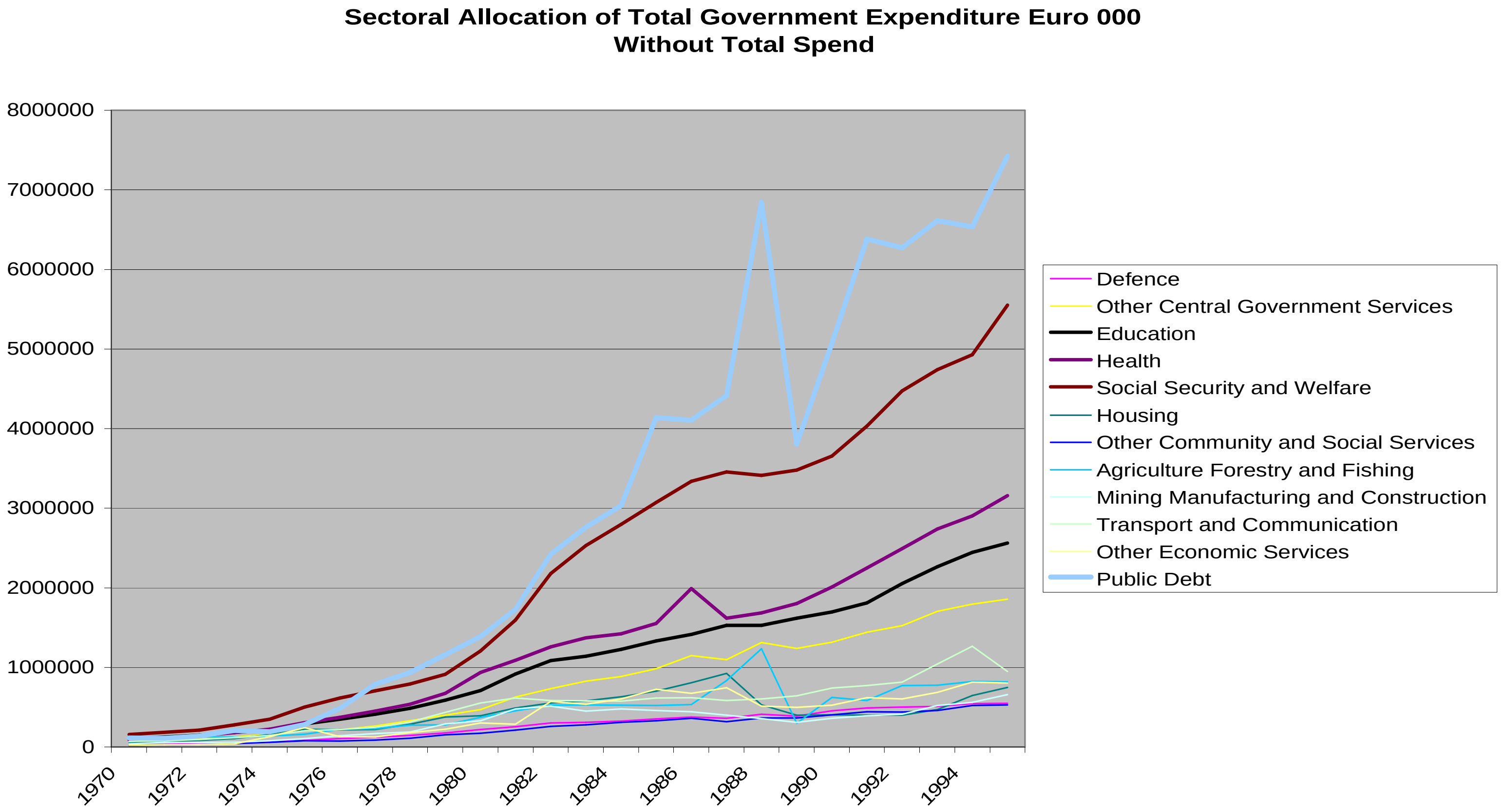
Source: ESRI Databank www.esri.ie

Fig. 19. Government Current Spending in Constant 1990 Prices – Ireland



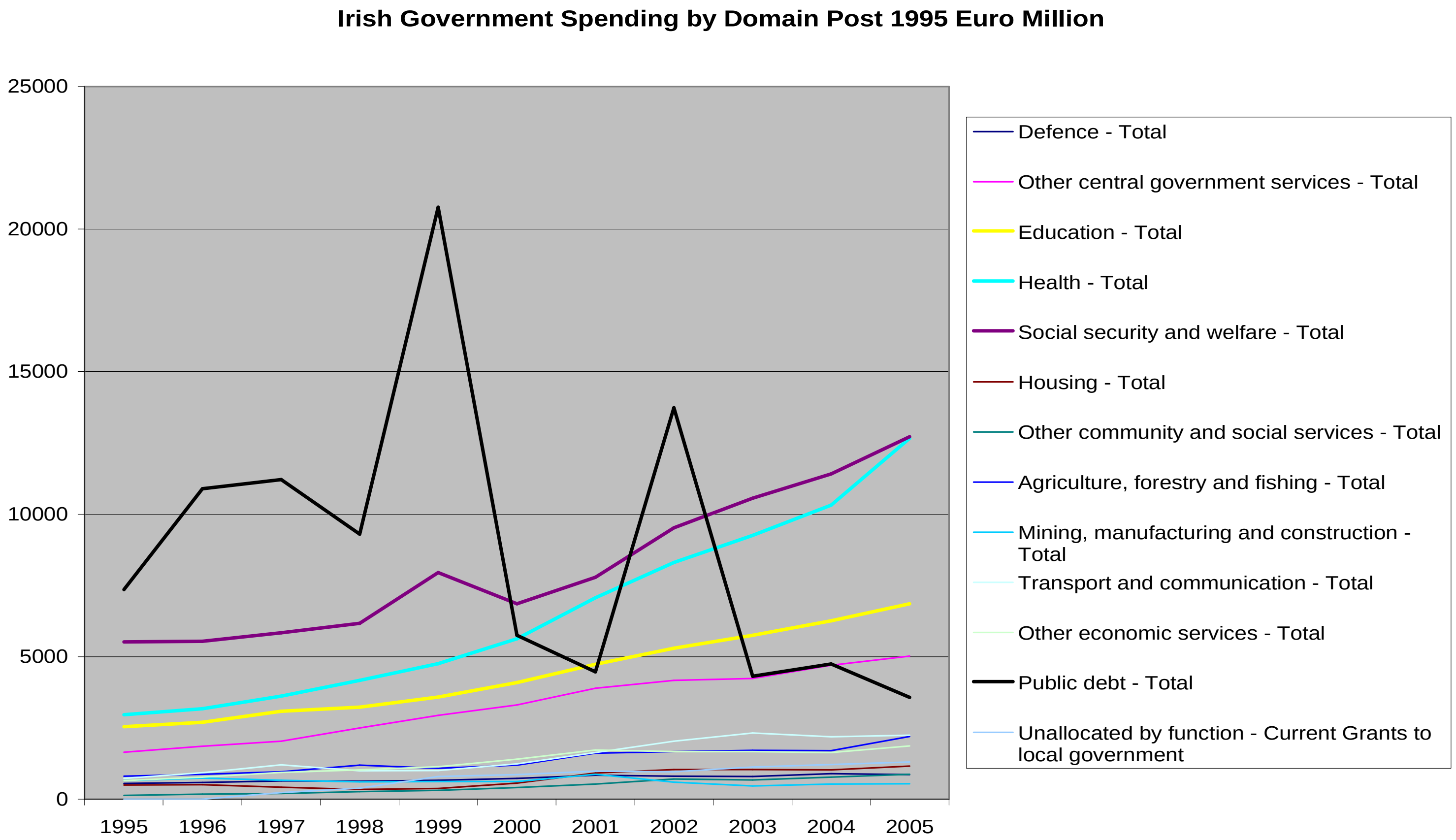
Source: OECD Databank

Fig. 20. Sectoral Allocation of Government Total Spending, 1960-1995



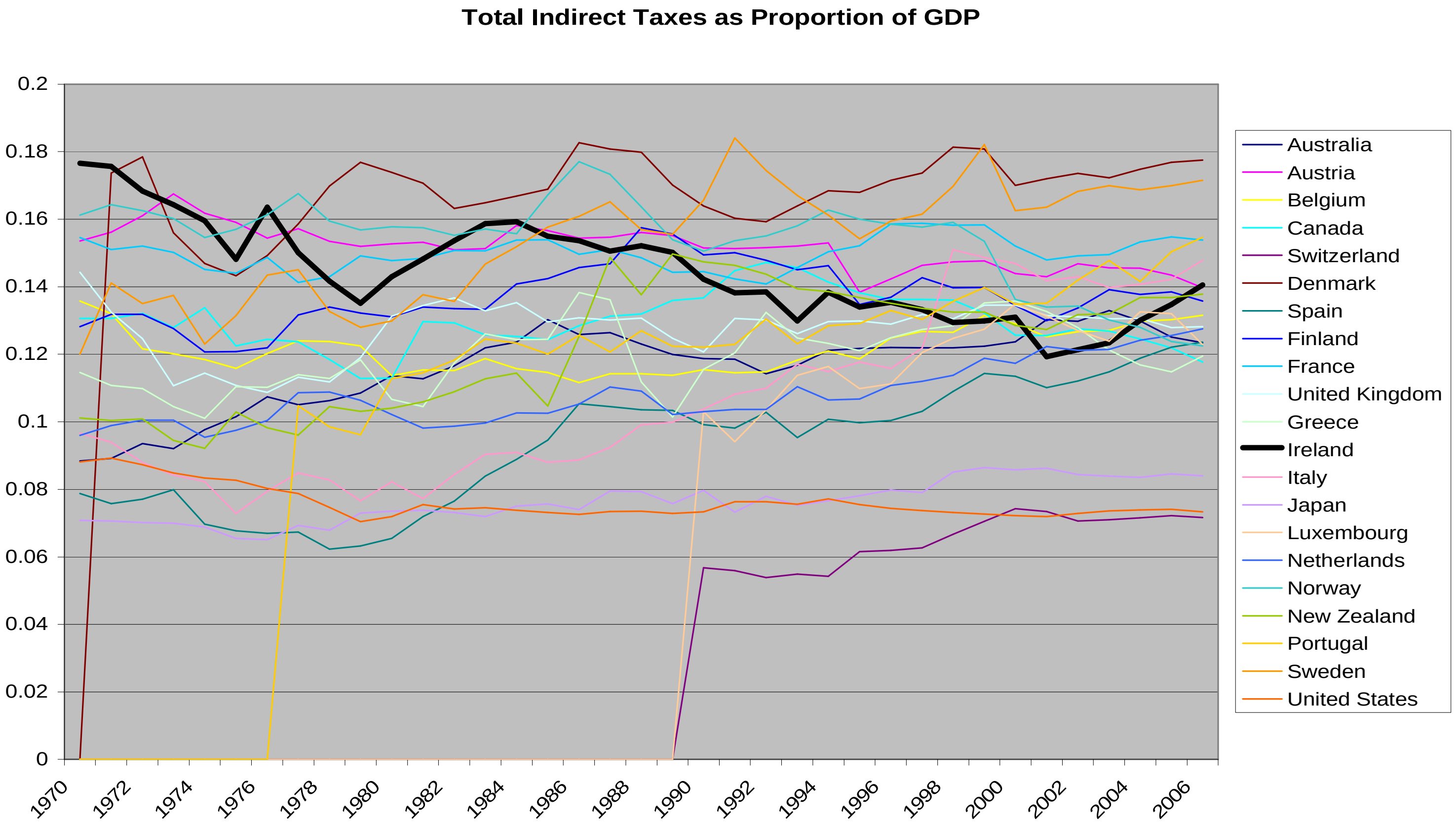
Source: Central Statistice Office, www.cso.ie

Fig. 21. Irish Government Spending by Policy Domain, 1995-2005



Source: Central Statistics Office, www.cso.ie

Fig. 22. Indirect Taxation as % GDP – OECD



Source: OECD

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